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Sup. Ct.

# TRANSCRIPT OF RECORD

## SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, ~~1944~~ 5

No. ~~1125~~ 55

THE UNITED STATES OF AMERICA AND FEDERAL COMMUNICATIONS COMMISSION, APPELLANTS

vs.

NEW YORK TELEPHONE COMPANY

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

FILED APRIL 7, 1945

# SUPREME COURT OF THE UNITED STATES

## October Term, 1944

## No. 1125

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A In District Court of the United States for the Southern District of New York

Civil Acttion File No. 24–211

NEW YORK TELEPHONE COMPANY, PLAINTIFF

*v.*

UNITED STATES OF AMERICA AND FEDERAL COMMUNICATIONS COMMISSION, DEFENDANTS

*Summons*

*To the above named Defendants:*

You are hereby summoned and required to serve upon Henry J. Friendly, one of the plaintiff's attorneys, whose address is 31 Nassau Street, New York, N. Y., an answer to the complaint which is herewith served upon you, within sixty days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

(Signd.) GEORGE J. H. FOLLMER,
*Clerk of Court.*

Date: February 11th, 1944.

NOTE.—This summons is issued pursuant to Rule 4 of the Federal Rules of Civil Procedure.

B SUMMONS IN CIVIL ACTION

Returnable not later than sixty days after service.

Ralph W. Brown, 140 West Street, New York, N. Y.; Frank A. Fritz, 140 West Street, New York, N. Y.; Henry J. Friendly, 31 Nassau Street, New York, N. Y., Attorneys for plaintiff.

[File endorsement omitted.]

1 In United States District Court, Southern District of New York

NEW YORK TELEPHONE COMPANY, PLAINTIFF

*v.*

UNITED STATES OF AMERICA AND FEDERAL COMMUNICATIONS COMMISSION, DEFENDANTS

*Complaint*

Filed Feb. 11, 1944

*To the Honorable the Judges of Said District Court:*

Plaintiff, New York Telephone Company, brings this action pursuant to the provisions of the Communications Act of 1934,

approved June 19, 1934 (48 Stat. 1064, 1093; Code of Laws of the United States, Tit. 47, Sec. 402 (a)) and of the Urgent Deficiencies Appropriations Act, approved October 22, 1913 (38 Stat. 219, 220; Code of Laws of the United States, Tit. 28, Sec. 41 (28), 43–48 inclusive), permanently to enjoin, set aside, annul and suspend an order of the Federal Communications Commission, dated December 14, 1943, in the proceeding which is said Commission's Docket No. 6329, to which plaintiff was a party, and for its cause of action alleges upon information and belief as follows:

## The Plaintiff

1. Plaintiff is a corporation duly organized and existing under the laws of the State of New York. Plaintiff has its principal office in the City of New York, State of New York, and in the Southern District thereof. Plaintiff maintains, and at all times referred to in this complaint has maintained, its principal books of account in the City of New York, State of New York, and in the Southern District thereof.

2 2. Plaintiff has been engaged since its incorporation in 1896, and is now engaged, in the business of furnishing telephone service to the public in the States of New York and Connecticut. In that business it furnishes local or exchange telephone service in towns, cities, and other localities in said states. It also furnishes intrastate and interstate toll or long distance service between points in said states and interstate and foreign toll service through physical connection with the lines of other telephone companies between points in said states and points outside thereof.

## The Defendants

3. The United States of America is made a party defendant in this suit pursuant to said Acts of Congress hereinbefore named.

4. The Federal Communications Commission (sometimes hereinafter referred to as "the Commission") is an administrative agency created by the Communications Act of 1934 and is charged with the execution and enforcement of said Act.

## The Nature of the Commission's Order

5. A copy of the Commission's order dated December 14, 1943 (sometimes hereinafter referred to as "the Order"), together with the Commission's Report which was made a part thereof, is annexed hereto marked "Exhibit A" and made a part hereof.

6. By the Order the Commission directed the plaintiff to reduce its surplus, as recorded on its books, by $4,166,510.57, this being an amount equal to the excess of the payments by the plaintiff to American Telephone and Telegraph Company (hereinafter referred to as "the American Company") for certain telephone plant purchased in the years 1925, 1926, 1927, and 1928, over the amount found by the Commission to represent the net book cost of such plant on the books of the American Company at the time of said purchases; to restate its investment in certain plant
3 so acquired at an amount less by $481,439.60 than the actual cost of such plant to the plaintiff; to restate its investment in certain other plant so acquired at an amount greater by $194,886.97 than the actual cost of such plant to the plaintiff; to balance the changes in its accounts required by the foregoing action by adding to its already adequate depreciation reserve the amount of $3,879,957.94; and to make various other entries in its accounts as set forth in the Order.

## The Transactions Here in Question

### A. The Purchases of Toll Plant

7. Prior to 1925 the American Company had furnished intrastate toll or long distance service between certain points within the State of New York. In 1925 it was agreed between the American Company and the plaintiff that the business of furnishing said intrastate toll or long distance service should be transferred to the plaintiff, which would perform the services theretofore performed by the American Company. The business so transferred was profitable in character, and the transfer of such business was reasonable and proper both as to the plaintiff and as to its subscribers.

8. In order to conduct the intrastate toll or long distance business so transferred, plaintiff purchased from the American Company certain outside toll plant (primarily poles, crossarms, guys and anchors, aerial wire and cable, underground cable, loading coils, conduit, and right-of-way) which had theretofore been owned by the American Company and used by it in the conduct of the business so transferred to the plaintiff. This property was acquired by the plaintiff in two transfers, as of November 1, 1925, and September 1, 1926, respectively.

9. As of December 31, 1928, the plaintiff purchased from the American Company a small amount of additional toll plant. This toll plant was required in order to handle certain interstate toll business which had been transferred by the American Company to the plaintiff.

4 10. The plaintiff paid the American Company for the property described in paragraphs 8 and 9 of this complaint the following purchase price:

| | |
|---|---|
| 1925 sale | $5,831,884.78 |
| 1926 sale | 97,310.39 |
| 1928 sale | 44,246.30 |
| Total | 5,973,441.47 |

This purchase price was agreed upon as being an amount equal to the structural value of the property, that is to say, the estimated cost of replacement or reproduction of the property less deterioration to the then existing conditions through wear and tear, obsolescence and inadequacy. The structural value of the property was determined by means of a field inspection and a detailed appraisal made in accordance with recognized engineering principles and procedures by experienced and well qualified inspectors and engineers. The purchase price paid by the plaintiff to the American Company for the property purchased was fair, reasonable and not in excess of the value of said property.

### B. THE PURCHASE OF THE TELEPHONE "INSTRUMENTS"

11. Prior to December 31, 1927, the American Company, as holder of the fundamental Bell patents, owned three small but essential parts of the telephone equipment placed upon the premises of subscribers by the plaintiff and other companies which were licensed to use this equipment. These parts, to wit, the transmitter, the receiver, and an induction coil, were commonly known and are hereinafter referred to as "the instruments."

12. On December 31, 1927, the American Company sold to the plaintiff the instruments then in the service or in the supplies of the plaintiff. The plaintiff paid the American Company for the instruments so purchased $6,661,238.91. The purchase price was based upon the average price charged the American Company by Western Electric Company, the manufacturer of the instruments, during the first nine months of 1927, less an allowance
5 of 20% to reflect the then condition of the instruments. The said purchase price was approved by qualified engineers of the plaintiff, after investigation, as a fair and reasonable price. The said purchase price paid by the plaintiff to the American Company for the instruments was fair, reasonable, and not in excess of the value of said instruments. Similar sales of instruments were made at the same time and at the same price to all of the licensee companies of the American Company, including companies which were not controlled by the American Company.

## THE RELATIONSHIP BETWEEN THE PLAINTIFF AND THE AMERICAN COMPANY

13. The plaintiff is, and at all times referred to in this complaint has been, a separate and distinct corporate entity managed in its own interest by its own officers and directors. Although, at the time of the transactions referred to in paragraphs 7 to 12 inclusive of this complaint, the American Company owned all of the outstanding common stock of the plaintiff, throughout such time the plaintiff had outstanding in the hands of the public 250,000 shares of its 6½% $100 Cumulative Preferred Stock and in excess of $132,000,000 of Mortgage Bonds issued under three indentures between the plaintiff and various mortgage trustees, none of which shares of Preferred Stock or Mortgage Bonds were owned, directly or indirectly, by the American Company; and throughout such time all of the plaintiff's officers and at least two-thirds of plaintiff's directors were not directors, officers or employees of the American Company, and the plaintiff had its own employees, property and business, separate and apart from the employees, property and business of the American Company. At all times referred to in this complaint the plaintiff and the American Company have maintained separate and distinct records and accounts and have been required so to do by the regulatory authorities to which the plaintiff and the American Company were subject.

6 ## THE LAW CONTROLLING PLAINTIFF'S ACCOUNTING AT THE TIME OF THE PURCHASES OF THE TOLL PLANT AND INSTRUMENTS FROM THE AMERICAN COMPANY

14. At the time of the transactions referred to in paragraphs 7 to 12 inclusive of this complaint, the plaintiff was a telephone company "engaged in sending messages from one State, Territory or District of the United States to any other State, Territory, or District of the United States," within the meaning of Section 1 of the Interstate Commerce Act as amended by Section 7 of the Act approved June 18, 1910, 36 Stat. 539, 544; was subject to Section 20 of the Interstate Commerce Act, 24 Stat. 379, 386, as amended by the Act of June 29, 1906, 34 Stat. 584, 593, 594; and was prohibited by the said Section 20 from keeping any other accounts, records, or memoranda than those prescribed by the Interstate Commerce Commission.

15. The Interstate Commerce Commission, pursuant to the authority vested in it by said Section 20 of the Interstate Commerce Act as amended, entered an order, dated December 10, 1912, prescribing for certain telephone companies, including plaintiff,

a uniform system of accounts entitled "Uniform System of Accounts for Telephone Companies, First Issue" effective January 1, 1913. Said system was amended in minor respects by subsequent orders, dated December 22, 1914, July 24, 1923, January 8, 1925, and December 19, 1927. Said system was interpreted by an order of the Interstate Commerce Commission dated June 26, 1916, approving Accounting Bulletin No. 11.

16. Instruction 10 of the said "Uniform System of Accounts for Telephone Companies, First Issue" provided:

"10. Costs to be actual money costs.—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. When the consideration actually given for anything with respect to which a charge is made to any
7 fixed capital or other property account is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount charged should be the actual money value of such consideration at the time of the transaction."

17. Instruction 13 of said "Uniform System of Accounts for Telephone Companies, First Issue" provided:

"13. Plant and equipment and other property purchased.—When any property in the form of a going or completed plant is purchased, an appraisal of the property so acquired should be made, and the different constitutent elements of the plant (and equipment, if any) or other property acquired should be appraised at their structural value; that is to say, at the estimated cost of replacement or reproduction less deterioration to the then existing conditions through wear and tear, obsolescence, and inadequacy. If the actual money value of the consideration given for the plant or other property was at the time of the acquisition in excess of such appraised value, the excess should be charged to account No. 204, 'Other Intangible Capital,' and the appraised values of the constituent elements should be charged to the appropriate fixed capital accounts as hereinafter designated. If the actual money value of the consideration given was not in excess of such appraised value, such actual money value should be distributed through the said accounts in proportion to the said appraised value of the constituent elements appropriate to the respective accounts.

"Companies should be prepared to furnish the Commission, upon demand, a full report of the contract of acquisition, the consideration given therefor, the determination of the actual money value of such consideration if other than money, the appraisal, and the amounts charged to the respective accounts for
8 each plant or other such fixed capital purchased. The pur-

chaser is required to procure in connection with the acquisition of any such plant or other fixed capital all existing records, memoranda, and accounts in the possession or control of the grantor relating to the construction and improvement of such plant, and to preserve such records, memoranda, and accounts until authorized by law to destroy or otherwise dispose of them."

18. Said Accounting Bulletin No. 11 adopted by the order of the Interstate Commerce Commission, dated June 26, 1916, provided in Case No. 30 thereof:

"Query.—What items should be classified as 'going or completed plant' under section 13, page 33, 'Plant and equipment and other property purchased' of the Uniform System of Accounts for Class A and B companies?

"Answer.—The term 'going or completed plant' is intended to cover only the entire plant of a telephone company or an important unit thereof; such as—

(1) A telephone company as a whole,
(2) An entire central office,
(3) A system of lines and stations within a given area, or
(4) A complete section of toll plant.

"The purchase by one company from another of several poles and appurtenances, a switchboard, or other minor portions of plant shall be treated in the same manner as the purchase of materials and supplies; i. e., the purchasing company shall charge the fixed capital accounts at cost, as provided in section 10, page 33, of the Uniform System of Accounts for Class A and B companies."

## 9 THE ACCOUNTING PERFORMED BY PLAINTIFF WITH RESPECT TO THE PURCHASES OF TOLL PLANT AND INSTRUMENTS FROM THE AMERICAN COMPANY

### A. THE TOLL PLANT

19. The acquisition of the toll plant set forth in paragraphs 7 to 10 inclusive of this complaint constituted the acquisition of "a complete section of toll plant" within the meaning of Case No. 30 in Accounting Bulletin No. 11 of the Interstate Commerce Commission as set forth in paragraph 18 of this complaint. Accordingly, the accounting for these acquisitions was governed by Instruction 13 of the Uniform System of Accounts for Telephone Companies then in effect as set forth in paragraph 17 of this complaint. Since the purchase price paid by the plaintiff for each type of plant, equipment and other property acquired was the structural value determined by appraisal, as set forth in paragraph 10 of this complaint, the actual money cost of the property purchased, to

wit, $5,973,441.47, was distributed among the various plant accounts in the precise amount of the appraised structural value of the various types of property purchased.

### B. THE INSTRUMENTS

20. The acquisition of the instruments set forth in paragraphs 11 and 12 of this complaint did not comprise the acquisition of a "going or completed plant" within the meaning of Case No. 30 of Accounting Bulletin No. 11 of the Interstate Commerce Commission, as set forth in paragraph 18 of this complaint. Accordingly, the accounting for these acquisitions was governed by Instruction 10 of the Uniform System of Accounts for Telephone Companies then in effect, as set forth in paragraph 16 of this complaint. The instruments were recorded in the plant accounts at the amount paid by the plaintiff to the American Company for the instruments, to wit, $6,661,238.91, this price having been determined as set forth in paragraph 12 of this complaint.

## 10 THE COMMUNICATIONS ACT OF 1934, THE COMMISSION'S UNIFORM SYSTEM OF ACCOUNTS, AND THE JUDICIAL PROCEEDINGS RELATING TO THE COMMISSION'S SYSTEM OF ACCOUNTS

21. The Interstate Commerce Commission's "Uniform System of Accounts for Telephone Companies, First Issue," interpreted and amended as above set forth, continued in effect until January 1, 1933. By order dated November 12, 1932, the Interstate Commerce Commission adopted a uniform system of accounts entitled "Uniform System of Accounts for Telephone Companies, First Revised Issue," effective, as to the plaintiff, as of January 1, 1933. Said Uniform System of Accounts, First Revised Issue, continued in effect until January 1, 1937, the effective date of the Uniform System of Accounts for Telephone Companies prescribed by the Federal Communications Commission. Said First Revised Issue of the Interstate Commerce Commission's Uniform System of Accounts did not require any change in the accounting which had been performed by plaintiff with respect to the transactions referred to in this complaint.

22. The Communications Act of 1934, 48 Stat. 1064, Code of Laws of the U. S., Tit. 47, Secs. 151 ff., was approved June 19, 1934, and became effective upon the organization of the Commission on July 11, 1934. Plaintiff is, and at all times since the effective date of the Communications Act of 1934 has been, a person engaged within the United States in interstate and foreign communication by wire or radio, within the meaning of Sec. 2 of said Act (Code of Laws of the U. S., Tit. 47, Sec. 152).

23. Sec. 220 of the said Act provides, in subdivisions (a) and (g) thereof, as follows:

"(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records,
11 and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

* * * * * *

"(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect."

24. On June 19, 1935, the Commission issued an order designated Telephone Division Order No. 7-C prescribing for the use of certain telephone companies subject to the Communications Act of 1934, including plaintiff, a system of accounts entitled "Uniform System of Accounts for Telephone Companies, Issue of June 19, 1935, effective January 1, 1936." The said Uniform System of Accounts differed from both of the Uniform Systems of Accounts theretofore prescribed for telephone companies by the Interstate Commerce Commission, among other respects, in requiring that in the case of certain acquisitions of property previously in telephone service, entries should be made showing the "original cost" to the first utility dedicating said property to the public use, and that any excess of the purchase price of said property over said "original cost" less the amounts of reserve requirements for depreciation and amortization of the property acquired should be charged to Account 100.4, "Telephone Plant Acquisition Adjustment." The instructions pertaining to the said Account 100.4 provided, among other things, that:

"The amounts recorded in this account with respect to
12 each property acquisition shall be disposed of, written off or provision shall be made for the amortization thereof in such manner as this Commission may direct."

25. Upon the promulgation of the Commission's said proposed Uniform System of Accounts, plaintiff and a number of other telephone companies filed in this Court a complaint against the defendants herein, in a proceeding entitled "American Telephone and Telegraph Company, et al., plaintiffs, against United States

of America and Federal Communications Commission, defendants, In Equity No. 81–366," to enjoin, set aside, annul and suspend the said proposed Uniform System of Accounts. The said complaint and the record in the said suit in this Court and in the Supreme Court of the United States are incorporated herein by reference as fully as if herein set forth at length.

The primary ground of said complaint was that the proposed Uniform System of Accounts would require the plaintiffs to write off from their investment accounts amounts which had been paid by them to other utility companies for telephone plant, to the extent that amounts so paid exceeded the original cost of said plant to the telephone company which had first dedicated it to the public use less the depreciation reserve requirement at the time of purchase. In particular, the plaintiffs set forth, in their complaint and in the affidavits submitted in support of their application for a preliminary injunction, that large amounts of property, acquired partly from affiliated and partly from independent companies, had been recorded on the books of the plaintiffs at its actual cost to them; that the provisions of the proposed Uniform System of Accounts (referred to in paragraph 24 of this complaint) required that plaintiffs restate their then existing property investment accounts by eliminating therefrom their recorded cost or investment in property so previously acquired by them from another public utility and by substituting for such recorded cost or investment the amount which said property cost some former owner at the date of first dedication to public use;
13 and that where plaintiffs had theretofore purchased property at a price higher than its cost to the predecessor utility which first dedicated it to the public use, the said provisions of the proposed Uniform System of Accounts required the plaintiffs to write off a portion of their actual investment even where the price paid was the actual value of the property and where there had since been no change in value, thus requiring the plaintiffs to record a loss on their books when in fact they had suffered no loss.

26. The defendants herein denied in the said suit that the proposed Uniform System of Accounts had the meaning or effect of requiring a write-off of the excess of the purchase price to another utility over the "original cost" of the property and asserted that the effect of the said proposed Uniform System of Accounts was merely to require a reclassification of existing balances among various accounts for the better information of the regulatory authorities. In its answer to the said complaint, filed in this Court on December 13, 1935, the Commission denied "that the definition of original cost taken in connection with other provisions of the Uniform System of Accounts will require the plaintiffs

so to restate, as of January 1, 1936, their property investment accounts by eliminating therefrom the recorded cost or investment of the plaintiffs in property theretofore acquired by them from another public utility." In its answer to the said complaint, filed in this Court on December 23, 1935, the United States of America denied "that the definition of 'original cost' as contained in and read with the context of the Uniform System of Accounts will require plaintiffs in substance or in effect to so restate as of January 1, 1936, their property investment accounts by eliminating therefrom their recorded cost or investment in property theretofore acquired by them from another public utility."

27. The said suit was submitted to this Court for final determination upon the pleadings, affidavits and briefs submitted upon the application for an interlocutory injunction. This Court entered a decree restraining the enforcement of the proposed Uni-
14 form System of Accounts as to two items, and otherwise denied the injunction prayed for by the plaintiffs, but did so in express reliance upon the above mentioned representations of the defendants as to the construction and effect of the said System of Accounts, as is shown in this Court's findings of fact Nos. III–XIII inclusive. Said findings are set forth in Exhibit B which is annexed hereto and made a part hereof.

28. The defendants in the said suit took no appeal from the judgment of this Court. The plaintiffs in said suit, including the plaintiff herein, appealed to the Supreme Court of the United States. The plaintiffs contended in their appeal that the proposed Uniform System of Accounts was illegal and void primarily in that it would enable the Commission to require the accounting company to write off to surplus amounts paid to another public utility for property in excess of cost to the company first dedicating the property to the public use. The defendants herein defended the appeal on the ground that the purpose of the provisions in question was not to permit the Commission to compel such a write-off but to reveal information necessary to the regulatory functions of the Commission. The Supreme Court affirmed the judgment of this Court in an opinion reported in 299 U. S. 232. The said opinion expressly took note of the frequency of transfers between member companies of the Bell System and upheld the proposed Uniform System of Accounts as a means for obtaining full information with respect to such transfers and as not affecting the rights of the accounting company to retain in its investment accounts an excess of purchase price over original cost which was a true increment of value. Moreover, in order "to avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed" (299 U. S.

at 241), the Supreme Court required the United States and the Commission to file with it a memorandum embodying the interpretation of the proposed Uniform System of Accounts on which the defendants had relied in defending the said suit, and the
15 Court accepted "this declaration as an administrative construction binding upon the Commission in its future dealings with the companies" (299 U. S. at 241). A copy of the memorandum so filed is annexed hereto marked Exhibit C and made a part hereof.

29. After the determination of the said suit by the Supreme Court of the United States, the Commission promulgated its Uniform System of Accounts for Class A and Class B Telephone Companies, effective January 1, 1937. The instructions in said System of Accounts with respect to the accounting for telephone plant acquired did not vary substantially from the corresponding instructions in the proposed Uniform System of Accounts, which had been prescribed to be effective January 1, 1936, but which had not taken effect pending the final determination of the suit referred to in paragraphs 25 to 28 inclusive of this complaint, except that Instruction 31.2–21 provided that the "original cost" method of accounting was required only "when property comprising a substantially complete telephone system, exchange, or toll line is acquired from predecessors," and that the accounting for other property acquired from predecessors "shall be on the basis of the amount of money actually paid (or the current money value of any consideration other than money exchanged for such property."

## Plaintiff's Depreciation and Retirement Accounting and Rates

30. Pursuant to the provisions of the Uniform System of Accounts for Telephone Companies prescribed by the Interstate Commerce Commission and the Commission, plaintiff has followed the group method of depreciation accounting. Under this system of depreciation accounting, the plaintiff has charged depreciation expense for each class of depreciable plant, including the plant purchased from the American Company as set forth in paragraphs 7 to 12 inclusive of this complaint. The depreciation expense so charged has been the product of applying to the book bal-
16 ances for each class of depreciable plant, rates estimated by plaintiff's management to be adequate to distribute evenly the loss in service value of the property in such class, under the straight-line method of depreciation. In determining such rates consideration has been given to the service lives and salvage developed by studies of the plaintiff's history and ex-

perience; to the fact that at the time of acquisition of certain of plaintiff's property, including the property purchased from the American Company as set forth in paragraphs 7 to 12 inclusive of this complaint, a portion of the service life of said property had expired; to such engineering and other information as was available with respect to past and probable future conditions; and to all other relevant facts. The charges so made by the plaintiff for depreciation expense have been reasonable and adequate.

31. Depreciation expense charged by plaintiff to operating expenses, as set forth in paragraph 30 of this complaint, has been concurrently credited to a depreciation reserve. This depreciation reserve is, and at all times from 1925 to date has been, a single reserve for all of plaintiff's depreciable property. At all times from 1925 to date, the plaintiff's depreciation reserve has been adequate in the light of the nature of plaintiff's depreciable property and the estimated service lives and salvage of such property, including the property purchased from the American Company as set forth in paragraphs 7 to 12 of this complaint.

32. The rates charged by plaintiff for its intrastate service in the State of New York, revenues from which comprise over 90% of plaintiff's total operating revenues, at all times from November 1, 1925, to date, have been rates which have been fixed and determined by the Public Service Commission of the State of New York, except that until July 1, 1926, plaintiff made certain charges in excess of such rates pursuant to an order of this Court finding that the rates so fixed and determined by the said Public Service Commission were confiscatory.

17 33. In determining the rates to be charged by the plaintiff for its intrastate service in the State of New York, the said Public Service Commission of the State of New York, in rate proceedings before it, has made its own estimates of plaintiff's annual requirements for depreciation, and has fixed plaintiff's rates upon the basis of said estimates and not upon the basis of plaintiff's actual depreciation charges. In the suit in equity in this Court entitled "New York Telephone Company, Plaintiff, against William A. Prendergast et al., Defendants, In Equity No. 29-126," this Court in its opinion dated November 7, 1929, approved a finding estimating plaintiff's future depreciation charge at a composite rate of 5.1% per annum upon all of its depreciable property, including the property purchased from the American Company as set forth in paragraphs 7 to 12 inclusive of this complaint. The depreciation rate so approved by this Court was adopted by the Public Service Commission of the State of New York in fixing rates to be charged by the plaintiff for intrastate telephone service within the State of New York in its decision in its Case No. 6177 dated May 1, 1930. Plaintiff's composite depreciation rate was reduced

to 4.5% per annum in 1933, and to 4.18% per annum on January 1, 1936. In its decision dated June 29, 1936, in its Case No. 8230, fixing reduced rates to be charged by the plaintiff for intrastate telephone service within the State of New York, the said Public Service Commission determined the said composite rate of 4.18% per annum to be higher than required and that plaintiff should file new and revised rates. Plaintiff thereupon made a reduction of approximately 10% in its depreciation rates. The facts as to the acquisitions of property by the plaintiff from the American Company set forth in this complaint were presented to this Court in the above mentioned suit in equity (No. 29-126), to which the said Public Service Commission was a party defendant, and the said Public Service Commission was then and at all times subsequent thereto has been fully apprised in regard to such acquisitions. No orders have been made by the Federal Communications
18 Commission fixing depreciation rates for the plaintiff pursuant to Sec. 220 of the Communications Act of 1934.

34. From time to time, after the acquisition of the toll plant and the instruments referred to in paragraphs 7 to 12 inclusive of this complaint, certain units of said toll plants and instruments have been retired. Units so retired have been written out of the plant accounts at the amount at which such units had been recorded therein, and the same amount, less any salvage resulting from the retirement, has been charged concurrently to the depreciation reserve.

35. Out of the toll plant purchased from the American Company in 1925, 1926, and 1928 at a cost of $5,973,441.47 as set forth in paragraphs 7 to 10 inclusive of this complaint, there remained in the plant accounts of the plaintiff, as of January 1, 1937, toll plant having an estimated book cost to the plaintiff of $2,971,058.99, and, as of January 1, 1942, toll plant having an estimated book cost to the plaintiff of $2,611,586.39. Out of the instruments purchased from the American Company in 1927 at a cost of $6,661,238.91 as set forth in paragraphs 11 and 12 of this complaint, there remained in the plant accounts of the plaintiff, as of January 1, 1937, instruments having an estimated book cost of $2,433,105.41, and, as of January 1, 1942, instruments having an estimated book cost of $630,279.13.

## Reclassification of Accounts Made by the Plaintiff After the Effective Date of the Commission's Uniform System of Accounts

36. Upon the taking effect of the Commission's Uniform System of Accounts, the plaintiff proceeded to reclassify its accounts relating to such of the toll plant acquired from the American Company in 1925, 1926, and 1928, as remained in plaintiff's plant accounts as of January 1, 1937. Plaintiff recorded in Account 100.1 "Tele-

phone plant in service" the sum of $2,487,083.16, this being the book cost of such property to the American Company as appear-
19 ing on the books of the American Company at the time of the sale to the New York Company. Plaintiff also recorded in Account 100.4 "Telephone plant acquisition adjustment," the sum of $483,975.83, which was the amount by which $2,971,058.99, the estimated book cost of such property to the plaintiff as set forth in paragraph 35 of this complaint, exceeded the said sum of $2,487,083.16. The plaintiff did not reclassify the balances in its plant accounts relating to the instruments acquired from the American Company in 1927 for the reason that the instruments did not constitute "a substantially complete telephone system exchange, or toll line" within the meaning of Instruction 31.2-21 of the Commission's Uniform System of Accounts as set forth in paragraph 29 of this complaint.

## The Proceedings Before the Commission Herein

37. By order dated June 16, 1942, the Commission instituted an investigation into the accounting performed by the plaintiff with respect to the purchases described in paragraphs 7 to 12 inclusive of this complaint, and directed the plaintiff to show cause "why the total amount of $4,166,510.57, representing amounts paid to American Telephone and Telegraph Company by the respondent for telephone property acquired from American Telephone and Telegraph Company on November 1, 1925, September 1, 1926, December 31, 1927, and December 31, 1928, in excess of book cost less the related depreciation and amortization reserves, as reflected on the books of American Telephone and Telegraph Company and its Long Lines Department, should not be charged to New York Telephone Company's Account 413, 'Miscellaneous debits to surplus,' with concurrent entries to such accounts as may be appropriate in the light of the accounting performed at the time of and since the respective dates of the acquisitions of such telephone property." A copy of said order is annexed hereto marked "Exhibit D" and made a part hereof. The plaintiff herein filed an answer to said order to show cause, as required.
20 A copy of said answer is annexed hereto marked "Exhibit E" and made a part hereof. Thereafter hearings were held by the Commission together with the New York Public Service Commission which had instituted a prior general investigation into the accounts of the plaintiff. On June 22, 1943, the Commission adopted a proposed report in said proceeding. The plaintiff filed exceptions to said proposed report. Thereafter, on September 22, 1943, oral argument upon such exceptions was had

before the full Commission. On December 14, 1943, the Commission adopted the Order complained of in this action.

38. The Order requires the plaintiff to debit its surplus account in the sum of $4,166,510.57, this being an amount equal to the excess of the amount paid by the plaintiff to the American Company for the toll plant and instruments purchased in the years 1925, 1926, 1927, and 1928, over the amount found by the Commission to represent the net book cost of such property on the books of the American Company at the time of said purchases. The Commission does not and could not base this requirement upon the provisions of its Uniform System of Accounts with respect to the reclassification of the balances existing in plaintiff's various accounts as of January 1, 1937, the effective date of said Uniform System of Accounts. Instead the Commission bases its requirement upon a determination that the accounting originally performed by the plaintiff was erroneous to the extent that plaintiff recorded any investment in the property acquired in excess of the net book cost of such property to the American Company, regardless of the amount paid by the plaintiff or the structural value of such property, and that this alleged error must be corrected even with respect to property which had been retired before January 1, 1937. The Order further requires the plaintiff to write off the entire amount which plaintiff had recorded in Account 100.4, as set forth in paragraph 36 of this complaint, as representing the excess of the cost of the toll plant acquired from the American Company which survived as of January 1, 1937, over the original cost thereof to the American Company; to increase the
21 amount at which the instruments, estimated by the Commission to be surviving as of December 31, 1941, are recorded in plaintiff's plant accounts, to an amount equal to the original cost of such instruments to the American Company; and to credit to depreciation reserve as of December 31, 1941, the sum of $3,879,957.94, this being the balance remaining after deducting from the debit of $4,166,510.57 required to be made to surplus, the excess of the credit to Account 100.4 arising from the reversal required to be made of the entries in that account with respect to the toll plant over the debit to Account 100.1 arising from the entries required to be made in that account with respect to the instruments, as above set forth.

39. On January 17, 1944, the plaintiff filed a petition with the Commission setting forth its intention to institute this action and praying that the Commission extend the time for the submission of proof as to the making of the entries required by its said order of December 14, 1943, to a date 30 days after the final determination herein, upon condition that plaintiff transfer from its Account 181, "Unappropriated surplus" to Account 180, "Surplus reserved,"

with appropriate notation, and maintain in said Account 180 during the pendency of this proceeding, the amount of $4,166,510.57 required by the Commission to be charged by plaintiff to its surplus account. On January 25, 1944, the Commission made an order upon said petition. Copies of said petition and order are annexed hereto marked, respectively, "Exhibits F and G," and made a part hereof.

## Necessity of and Grounds for Relief From the Commission's Order

40. The Order requires plaintiff to charge its surplus account because of the purchase of the property here in question, when in fact the plaintiff suffered no loss upon the purchase of said property; requires the plaintiff to increase its depreciation reserve, which is already adequate; prevents the plaintiff from re-
22 cording in its property accounts and from amortizing through its expense accounts the excess of the amount paid for toll plant acquired by the plaintiff from the American Company which remained in plaintiff's plant accounts as of January 1, 1937, over the original cost of the toll plant to the American Company, although the amount so paid was not in excess of the value of the property acquired, and represented an investment by the plaintiff in assets of continuing value and in depreciable telephone plant; and generally requires plaintiff to misstate its accounts, and particularly its surplus account and its depreciation reserve, so that plaintiff's accounts will no longer reflect the plaintiff's actual investment nor the value thereof, but will conceal the amount of said investment.

41. Plaintiff is required to make a large number of financial reports to the Commission, to the Public Service Commissions of New York and Connecticut, to various tax authorities both federal and state, to the Securities and Exchange Commission, to the New York Stock Exchange, to the holders of its Series C 3% Bonds, and to investors generally. Unless the Order is enjoined, set aside, annulled and suspended by this Court, plaintiff will be required in such reports as well as in its corporate records, to misstate and misrepresent the facts as to its assets, surplus, reserves, expenses and income to regulatory authorities, to its bondholders, and to the public.

42. The Order is not supported by substantial evidence, is entirely at odds with fundamental principles of correct accounting, is beyond the statutory power and authority of the Commission, and is illegal and void, for the following reasons among others:

a. The Order requires the correction of an alleged error in plaintiff's accounting, although no error was made and such

accounting was in accordance with the requirements of the Uniform System of Accounts for Telephone Companies pre-
23 scribed by the Interstate Commerce Commission, to which plaintiff was subject at the date when the transaction occurred:

b. The Order requires accounting for property purchased from an affiliated company, at a date prior to the effective date of the Federal Communications Commission's Uniform System of Accounts for Telephone Companies, in a bona fide transaction and at a fair price, which is wholly different from the accounting for property purchased from a company not so affiliated, although no provision of the Uniform System of Accounts for Telephone Companies prescribed by the Interstate Commerce Commission which was in effect at the time of the transactions here in question, or of the later revision of said System, or of the Uniform System of Accounts for Telephone Companies prescribed by the Federal Communications Commission, makes any distinction between purchases from an affiliated company and purchases from a company not so affiliated;

c. The Order prevents the plaintiff from showing in its accounts the facts as to the purchases of property made by it from the American Company as set forth in this complaint, and requires the plaintiff to account for the said purchases on a basis which will not reflect either the plaintiff's actual investment in the property acquired or the value thereof;

d. The Order compels the plaintiff to rewrite its accounts as if a rule of substantive law required that a purchase of property from an affiliated telephone company must be at the net book cost of the selling company or that a purchase on any other basis must be disregarded as "fictitious," although no such rule of substantive law existed at the time of the transactions here in question, or now exists, and although the Commission has not been vested with power to established any such rule of substantive law either prospectively or retroactively;

24 e. The Order prescribes a rule of accounting to be made retroactively effective with respect to transactions executed prior to the effective date of the Commission's Uniform System of Accounts and of the Communications Act of 1934;

f. The Order prescribes a rule of accounting to be made retroactively effective to a date when plaintiff's accounts were prescribed by the Interstate Commerce Commission, as the duly authorized agency of the Government, and the rule now sought to be made retroactively effective by the Commission is at variance with the accounting so prescribed by the Interstate Commerce Commission;

g. The Order does not direct a reclassification of the balances existing in plaintiff's accounts as of January 1, 1937, the effective date of the Commission's Uniform System of Accounts for Telephone Companies, but requires that certain of said balances be written off to plaintiff's surplus account and that a further write-off be made to plaintiff's surplus account in respect of property which had been removed from plaintiff's plant accounts and charged to its adequate depreciation reserve prior to the effective date of said Uniform System of Accounts;

h. The Order requires accounting which is contrary to the Commission's Uniform System of Accounts for Telephone Companies as construed by this Court and in "the administrative construction binding upon the Commission in its future dealings with the companies" filed by these defendants in the Supreme Court of the United States, in the suit initiated in this Court entitled, "American Telephone and Telegraph Company, et al., plaintiffs, against United States of America and Federal Communications Commission, defendants, In Equity No. 81-366," to which suit this plaintiff and these defendants were adverse parties;

25 i. The Order requires plaintiff to increase its depreciation reserve, although the undisputed evidence showed that plaintiff's depreciation reserve was adequate;

j. The Commission denied the plaintiff a fair hearing, particularly by depriving plaintiff of the opportunity to demonstrate fully that the amount paid by the plaintiff for the toll plant and instruments acquired by the plaintiff from the American Company did not exceed the value of the property so acquired; and

k. For the reasons above set forth the Order deprives the plaintiff of its liberty and property without due process of law in violation of the Fifth Amendment of the Constitution of the United States.

43. Plaintiff is advised and therefore alleges that if the Order is complied with, plaintiff will for the reasons and in the manner stated in this complaint suffer irreparable injury and damage, and that if the Order is not complied with, unless plaintiff is afforded the protection by permanent injunction which this Court alone is competent to grant, plaintiff and its officers and employees will under the terms of the Communications Act of 1934 and particularly under Sections 220, 501, and 502 thereof, be subjected to a multiplicity of suits and criminal prosecution and fines and penalties.

Wherefore, plaintiff prays:

(1) That a summons issue under the seal of this Honorable Court and a copy of said summons and of this complaint be served upon the United States and the Federal Communications Com-

mission as prescribed by Rules 4(d)(4) and 4(d)(5) of the Federal Rules of Civil Procedure.

26 (2) That this Court convene a specially constituted court of three judges as required by Tit. 28, Sec. 47, Code of Laws of the United States.

(3) That this Court adjudge, order and decree that said Order of the Commission is and has at all times been beyond the lawful authority of the Commission and in violation of the legal rights of the plaintiff and wholly illegal and void and that said order be permanently enjoined, set aside, suspended and annulled, and the enforcement thereof permanently restrained and enjoined.

(4) That plaintiff may have such other and further relief in the premises as to equity and justice may appertain and as may be deemed by this Court to be adequate and proper under the circumstances.

RALPH W. BROWN,
*Office and P. O. Address, 140 West Street,*
*New York, N. Y.,*
FRANK A. FRITZ,
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*New York, N. Y.,*
HENRY J. FRIENDLY,
*Office and P. O. Address, 31 Nassau Street,*
*New York, N. Y.,*
*Attorneys for New York Telephone Company.*

27 [*Duly sworn to by James W. Hubbell; jurat omitted in printing.*].

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28 *Exhibit A to complaint*

Before the Federal Communications Commission, Washington 25, D. C.

Docket No. 6329—P—30.

IN THE MATTER OF NEW YORK TELEPHONE COMPANY ACCOUNTING

Appearances; Edward L. Blackman, Esq., Ralph W. Brown, Esq., John H. Machan, Esq., and Frank A. Fritz, Esq., on behalf of New York Telephone Company; Harry Hertzoff, Esq., on behalf of the City of New York; R. J. McVeigh, Esq., and John T. Ryan, Esq., on behalf of the Public Service Commission of the State of New York; Daryal A. Myse, Esq., and Harold J. Cohen, Esq., on behalf of the Federal Communications Commission.

## Report of the Commission

(Commissioner Case not participating)

This proceeding was initiated by order of the Commission on June 16, 1942. The Order instituted a general investigation into the accounting performed and the accounts, records, and memoranda kept by New York Telephone Company (hereinafter sometimes referred to as "New York"), at the time of and during
29 the period since all of its several acquisitions of telephone
property, with respect to and as a result of such acquisitions. The Order made New York respondent and required it to show cause why the amount of $4,166,510.57 should not be charged to respondent's account 413, "Miscellaneous debits to surplus," with concurrent entries to such accounts as may be appropriate in the light of the accounting performed at the time of and since the respective dates of the four acquisitions with which such amount was associated. It was stated in the Order that the amount of $4,166,510.57 represented payments to American Telephone and Telegraph Company (hereinafter sometimes referred to as "A. T. & T.") by New York for telephone property acquired from A. T. & T. on November 1, 1925, September 1, 1926, December 31, 1927, and December 31, 1928, in excess of the book cost less the related depreciation and amortization reserves, as reflected on the books of A. T. & T. and its Long Lines Department.[1]

The order of June 16, 1942, also suspended all charges to operating expense accounts made by New York on and after January 1, 1942, for the purpose of, or in conjunction with, amortizing or otherwise disposing of amounts included in its Account 100.4 "Telephone plant acquisition adjustment," pending submission of proof by respondent of the propriety and reasonableness of such charges; and ordered respondent to cease and desist from making any such charges pending submission of such proof. An investigation was also ordered instituted to determine whether respondent or any of its officers and directors have violated the provisions of Account 100.4 (c),[2] Account 614,[3] Commission Order No. 60[4] or Section 220 (g) of the Communications Act of 1934. Respondent and each of its officers and directors were required to file
30 verified answers. Appropriate notice was given to the State
Commissions having jurisdiction with respect to New York

[1] The Long Lines Department of A. T. & T. operates a nation-wide system of interstate toll line circuits. A separate set of accounts is kept to reflect the separate operations of the Long Lines Department.

[2] Section 31.100, : 4 of the Commission's Rules and Regulations.

[3] Section 31.614 of the Commission's Rules and Regulations.

[4] Adopted July 12, 1939.

and to the National Association of Railroad and Utilities Commissioners. Although a hearing is not a prerequisite to action by the Commission under Section 220 of the Act, a hearing was ordered, with provision for its conduct jointly with hearings involving similar matters before the New York and Connecticut State Commissions. Under Section 220 of the Act respondent has the statutory burden of justifying the accounting entries questioned by the Commission. (Cf. Re Additional Charges to Operating Expense Account 672 (Relief and Pensions), F. C. C. Docket No. 5188, Decided December 2, 1942.)

On January 25, 1938, the New York State Public Service Commission had instituted its Case No. 9436 by an order of investigation into the books, records, and accounts of New York and as to its entries reflecting the acquisition of property acquired from other telephone companies. Hearings before that Commission had been held in February, 1938, and October, 1939, and the matter was set down for further hearing at the same time and place as the hearing ordered by this Commission in this proceeding. Joint hearings in both proceedings were held before Commissioners Walker and Wakefield, of this Commission, and Commissioners Maltbie and Van Namee of the New York State Public Service Commission, beginning July 30, 1942, and continuing intermittently to December 11, 1942. Proposed Findings of Fact and Conclusions and a supporting Brief were filed by New York. The Commission adopted a Proposed Report on June 22, 1943. Exceptions thereto and a supporting brief were filed on behalf of New York and its officers and directors, and oral argument was requested, which was thereafter held before the Commission en banc.

The New York State Public Service Commission is concurrently issuing its Report and Order in its proceeding. The conclusions reached by the New York Commission are generally similar to those in this Report and accompanying Order.

31 Among the twenty-two or more acquisitions of telephone property prior to January 1, 1937, reported by New York and covered by the Commission's investigation order of June 16, 1942, only four are involved in the show cause provisions of the order. These four were property acquisitions from A. T. & T. The amounts of money involved therein are a major portion of the total amount involved in all of New York's telephone property acquisitions from predecessor telephone companies. The hearings which were held herein were directed to these four acquisitions, and this report deals with the merits of the accounting performed with respect to those particular acquisitions only.

A. T. & T. has at all times material to this proceeding controlled New York through ownership of all of New York's common stock.

The four property acquisitions involved herein consisted of toll line properties and telephone instruments. The toll line properties were outside toll plant, principally poles, wires, and cables. In addition to telephone exchange service, New York furnishes both interstate and intrastate message toll service throughout New York State. At one time, A. T. & T., which conducts nationwide operations, also furnished both interstate and intrastate toll service in New York State. In the twenties, A. T. & T. decided to withdraw from intrastate toll business in New York State, and as a part of this plan, it transferred its intrastate toll business in New York State to New York. In connection with this transfer of the business, A. T. & T., in 1925 and 1926, made two of the four property transfers to which the Commission's show cause order of June 16, 1942, was directed. The third toll property transfer involved herein was one made in 1928, when a small amount of toll plant was transferred by A. T. & T. to New York in connection with the transfer by A. T. & T. to New York of certain interstate toll business. Much of the property acquired by New York in these three transfers was in the form of an additional interest in toll plant which was, prior to such acquisition, owned jointly by New York and A. T. & T. Portions of such acquired
32 property had been originally constructed by New York for A. T. & T., New York billing A. T. & T. for the cost of the construction, and A. T. & T. placing the property on its books at that cost. Those portions of the jointly-owned property constructed by New York, and as to which ownership was retained by New York, were recorded on New York's books at original cost of construction. During this same period, toll properties were similarly transferred from New York to A. T. & T.

The fourth property transfer to which the Commission's show cause order of June 16, 1942, was directed was that of the telephone "instruments," on December 31, 1927. In 1927, A. T. & T. decided to transfer ownership of the instruments to New York, as well as to its other Associated Companies, and on December 31, 1927, A. T. & T. transferred to New York the instruments then in the service or in the supplies of New York. Prior to that time, A. T. & T. had retained ownership of three essential parts of the telephone station used by the public. These parts were the transmitter, receiver, and induction coil, and are designated collectively as "the instruments." The other parts necessary for a complete telephone station, such as the stand, bell box, etc., were owned by New York. A. T. & T. furnished and maintained the instruments under a "license contract" between it and New York, similiar to that in effect between A. T. & T. and each of its other associated companies. Under this contract, which also covered other matters, New York paid A. T. & T. a specified percentage

of its gross revenues, 4% in 1927. The license contract fee was, when the instruments transfer was made, reduced from 4 to 2% of New York's gross revenues.

The above four transfers of property did not involve any change in the physical character of the plan involved, in the service rendered to the public, or the use of the plant in rendering the service. These transactions resulted in the transfer of certain expenses formerly comprised in operating costs of A. T. & T. to operating costs of New York, together with fixed charges and taxes connected with the ownership of the property; and,
33 as an offset, New York retained certain revenues it formerly turned over to A. T. & T.

The amounts involved in each of the above four property transfers are shown in Tables A and B, below.[5] In Table A are shown the book cost to A. T. & T., the related book depreciation and amortization reserves, and the net book cost to A. T. & T., with respect to each of the four property transfers, as of the time when such transfers occurred.[6]

TABLE A.—*Book Cost and Net Book Cost to A. T. & T. of Property Transferred to New York*

| Property group | Year of transfer | Book cost to A. T. & T. | Related depreciation and amortization reserves | Net book cost |
|---|---|---|---|---|
| Toll line property | 1925 | $5,010,340.19 | $801,858.95 | $4,208,481.24 |
| Toll line property | 1926 | 95,924.66 | 14,449.20 | 81,475.46 |
| Toll line property | 1928 | 28,077.64 | 4,144.78 | 23,932.86 |
| Total |  | 5,134,342.49 | 820,452.93 | 4,313,889.56 |
| Telephone instruments | 1927 | 8,135,224.98 | 3,980,944.73 | 4,154,280.25 |
| Grand Total |  | 13,269,567.47 | 4,801,397.66 | 8,468,169.81 |

34 In Table B, below, are shown, with respect to the four property transfers, the net book cost to A. T. & T. of the properties, the amounts that New York entered in its asset accounts as its book cost, and the "profit" to A. T. & T., consisting of the excess of the amounts so entered, over the net book cost to A. T. & T.

[5] There are terms used in Table A, and throughout this report, whose meaning should be clearly understood. The term "book cost" is the amount at which property is carried (whether rightly or wrongly) in the company's asset accounts. It may be in a given instance the original cost; it may be a price paid which is different from original cost; or it may be some other figure dependent on vagaries of bookkeeping. The term "net book cost" means the book cost minus the amount of depreciation and amortization reserves shown on the books which is related to the property for which the book cost is shown.

[6] For the purposes of this report only, it is assumed that the figures in the record herein for book cost to A. T. & T. of the plant in question represent the original cost of the plant, and that the book depreciation and amortization reserve figures determined by A. T. & T. and shown in the record as applicable to the plant transferred to New York are correct.

TABLE B.—*A. T. & T. Net Book Cost, Price and "Profit" on Property Transferred*

| Property group | Date of transfer | Net book cost to A. T. & T. | Recorded book cost to New York | Excess or "profit" to A. T. & T. |
|---|---|---|---|---|
| Toll line property | 1925 | $4, 208, 481. 24 | $5, 831, 884. 78 | $1, 623, 403. 54 |
| Toll line property | 1926 | 81, 475. 46 | 97, 310. 39 | 15, 834. 93 |
| Toll line property | 1928 | 23, 932. 86 | 44, 246. 30 | 20, 313. 44 |
| Total | | 4, 313, 889. 56 | 5, 973, 441. 47 | 1, 659, 551. 91 |
| Telephone instruments | 1927 | 4, 154, 280. 25 | 6, 661, 238. 91 | 2, 506, 958. 66 |
| Grand Total | | 8, 468, 169. 81 | 12, 634, 680. 39 | 4, 166, 510. 57 |

In recording on its books each of the above four property transfers, A. T. & T. credited its plant account with the amount of its book cost shown in Table A above, and debited its depreciation and amortization reserves with the amount shown for those reserves in Table A. In each case, New York recorded the transfer by entering in its plant acounts the total amounts of the "prices" assigned by A. T. & T. for the properties acquired. New York recorded no amount with respect thereto in its depreciation or amortization reserve accounts. In each of the four cases, the amount recorded by A. T. & T. as received from New York in excess of the net book cost to A. T. & T. of the plant transferred was credited by A. T. & T. to surplus accounts as profit on the transaction.[7] These excess amounts, or "profits," as shown in Table B, totalled $4,166,510.57. The Commission's order of June 16,
35 1942, herein, directs New York to show cause why this total amount should not be charged to New York's surplus.

This difference of more than four million dollars between the net book cost to A. T. & T. of the properties transferred and the amounts recorded in the books of New York is attributable to the fact that the original cost of the property transferred, and the depreciation which had been accrued therefor on the books of A. T. & T., were ignored. With respect to the three transfers of toll properties, the accounting was on the basis of "structural value" as of the time of the transfers, or estimated reproduction cost new minus a depreciation allowance, as determined by appraisals. The recorded cost of the instruments to New York was based upon the average price of new instruments purchased by A. T. & T. from the Western Electric Company (a subsidiary of A. T. & T.) during the first nine months of 1927, less 20% as representing the used condition of the instruments.

[7] The amount associated with the instrument transaction was credited by A. T. & T. to a special contingency surplus reserve account.

Prior to 1937 it appeared that none but routine entries were made by New York with respect to the plant transferred to it by A. T. & T. Although this property had been recorded in New York's plant accounts at amounts which purported to reflect all existing depreciation, and the property had a relatively short remaining life, special depreciation rates were not applied to the amounts recorded in New York's plant accounts for this property, the current depreciation rates applicable to the respective classes of plant being applied to these amounts as long as the property remained in service. From time to time, as portions of such acquired property were retired from service, estimated amounts, based upon the book cost to New York ("structural value" in this case) of the property, were retired on New York's books by credits of such amounts to its plant accounts, and debits of corresponding amounts (with allowance for salvage) to its depreciation or amortization reserves.

On January 1, 1937, the Commission's Uniform System of Accounts for Class A and Class B Telephone Companies
36 became effective[8] and its provisions are applicable to New York as a Class A telephone Company. New York was thus required to reclassify the amounts recorded in its then existing accounts to conform with the provisions of such Uniform System of Accounts.[9] Under "Balance Sheet Accounts—Investments" the System provides that Account 100.1, "Telephone plant in service,"[10] shall include "the original cost of the company's property used in telephone service at the date of the balance sheet as classified under Accounts 201 and 277, inclusive;" and that Accounts 100.2 and 100.3[11] shall include the original cost of telephone plant under construction and property held for future telephone use, respectively. The system further provides that Account 100.4,[12] "Telephone plant acquisition adjustment," shall include amounts "representing the difference between (1) the amount of money actually paid (or the current money value of any consideration other than money exchanged) for telephone plant acquired, plus preliminary expenses incurred in connection with the acquisition; and (2) the original cost of such plant, governmental franchises and similar rights acquired, less the amounts of reserve requirements for depre-

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[8] Part 31 of the Commission's Rules and Regulations. On June 19, 1935, the Telephone Division of the Commission (see 1 F. C. C. 3 and Order No. 20, 4 F. C. C. 41) adopted its Order No. 7–C which prescribed a Uniform System of Accounts for Telephone Companies having average annual operating revenues exceeding $50,000, effective January 1, 1936 (1 F. C. C. 45). The operation of Order No. 7–C was stayed because of the proceeding in the case of American Telephone and Telegraph Company v. United States, in which the Uniform System of Accounts was attacked by A. T. & T. After the decision of the Supreme Court of the United States on December 7, 1936 (299 U. S. 232), the Telephone Division adopted its Order No. 7–D amending its Order No. 7–C in certain respects and making the amended System of Accounts effective January 1, 1937 (3 F. C. C. 9).

[9] Section 31.01–2 (e) of the Commission's Rules and Regulations.

[10] Section 31.100 : 1 of the Commission's Rules and Regulations.

[11] Section 31.100 : 2 and 31.100 : 3 of the Commission's Rules and Regulations.

[12] Section 31.100 : 4 of the Commission's Rules and Regulations.

ciation and amoritization of the property acquired." "Original cost" as used in Accounts 100.1 to 100.4, inclusive, is defined in the System of Accounts by Section 31.01-3(x) of the Rules and Regulations as "the actual money cost of (or current money value of any consideration other than money exchanged for)
37 property at the time when it was first dedicated to the public use, whether by the accounting company or by predecessors."[13] New York was thus obliged to recognize specifically the existence of amounts in its plant accounts which up to that time had not been stated in terms of original cost. The principal amounts to be so recognized were those reflecting plant surviving from the four transfers previously described.

New York has not reclassified on an original cost basis the amounts in its accounts associated with the transfer of the telephone instruments in 1927. It contends that under the provisions of Instruction 21 of the Uniform System of Accounts,[14] it was not required to reclassify these amounts. As of January 1, 1942, it was estimated by New York that approximately 9½ to 15% of the instruments transferred to New York in 1927 remained in service.

In reclassifying its accounts as of January 1, 1937, New York estimated, on the basis of the book cost to it (i. e., "structural value"), the amounts pertaining to the surviving toll plant transferred to it by A. T. & T. in 1925, 1926, and 1928. Next, the original cost of such surviving plan, as originally reflected on the books of A. T. & T., i. e., book cost to A. T. & T., was determined. The latter figures were set up in Account 100.1 of New York to represent the amount of such surviving property as "plant in service." The difference between this "original cost" and the "structural value" was placed in Account 100.4. This amount was $483,975.83. No amount was credited to New York's Account 171, "Depreciation reserve,"[15] in the process of reclassification. In connection, however, with New York's plan for disposition of amounts included in Account 100.4 as a result of the reclassification with respect to plant involved in the three toll property transfers and estimated as surviving, New York transferred in 1937 from its Account 171 to its Account 172, "Amortization
38 reserve,"[16] an amount which, when supplemented by future accruals over the estimated remaining life of the plant at the then current depreciation rates for the respective plant classes, would provide a reserve equivalent to the amount in question in Account 100.4 at the termination of the life of the property involved.

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[13] See Section 213(c) of the Communications Act of 1934.
[14] Section 31.21 of the Commission's Rules and Regulations.
[15] Section 31.171 of the Commission's Rules and Regulations.
[16] Section 31.172 of the Commission's Rules and Regulations.

Table C below shows the amounts which were involved in New York's reclassification of the toll properties transferred to it by A. T. & T. in 1925, 1926, and 1928.

TABLE C.—*Reclassification of Surviving Toll Plant Transferred to New York by A. T. & T.*

| | (a) Book cost to N. Y. ("structural value") of plant acquired | (b) Estimated book cost to N. Y. of plant surviving as of Jan. 1, 1937 | (c) Original cost of surviving plant (book cost to A. T. & T.) | (d) Difference (b-c) charged to account 100.4 |
|---|---|---|---|---|
| 1925 Transfer | $5,831,884.78 | $2,843,934.61 | $2,373,142.45 | $470,792.16 |
| 1926 Transfer | 97,310.39 | 91,428.42 | 92,7[illegible] | R1,299.94 |
| 1928 Transfer | 44,246.30 | 35,605.96 | 21,213.02 | 14,482.94 |
| Total | 5,973,441.47 | 2,971,058.99 | 2,487,083.16 | 483,975.83 |

NOTE.—R=Credit item.

The adjustments made by New York in its reclassification of the property involved in the three toll plant transfers were limited to the surviving toll property, and to the asset accounts. The fact that the amount of "plant in service" was slightly reduced in the process of classification was largely accidental. Since the old entries reflected a depreciated appraisal figure and the new entries represented undepreciated original cost, and both were the result of estimates, it might easily have happened that the new amounts would have been greater than the old. This happened with respect to the 1926 transfer, which was increased in book cost by $1,299.27 (see Table C above), despite the fact that the amount paid by New York for this property in 1926 was $15,834.93 more than its net book cost to A. T. & T. (See Table B above.)

39 In 1938 New York began amortizing the amounts included in its Account 100.4 by charges and credits to its operating expense Account 614, "Amortization of telephone plant acquisition adjustment," with concurrent entries to its Account 172. From time to time, when portions of the acquired plant were retired, amounts in Account 100.4 were written out of that account with a concurrent entry to Account 172. These amortization charges to Account 614 from January 1, 1942, were the charges which were suspended, and which New York was ordered to cease and desist from making, by the Commission's Order of June 16, 1942, herein.

The accounting performed by New York with respect to the four property transfers involved herein was improper. This accounting resulted in a purely inflationary write-up of New York's plant accounts by the amounts entered therein in excess of the net book cost to the A. T. & T. of the plant involved. These

excess amounts represented a "profit" to A. T. & T. Since New York was then, as it is now, fully subject to control by A. T. & T., the intercompany profits to A. T. & T. resulting from the affiliated company transfers of property involved herein are fictitious or paper increments, and are as unreal as profits from interdepartmental transactions. These intercompany profits to A. T. & T. resulted from transfers of property which did not involve any change in the physical character of the properties involved or in their use, but only changes in the business arrangements between two affiliated companies. The transfer of property from the parent A. T. & T. to its subsidiary New York should not be permitted to convert the excess amounts over A. T. & T.'s net book cost from a fictitious intercompany profit to an investment in assets by New York. That this intercompany profit lacks reality was recognized by accounting witnesses presented by New York, who testified that the consolidated surplus of A. T. & T. and its subsidiaries, including New York, should be corrected for inflation due to intercompany transfers of property such as those involved herein, by the elimination from the consolidated surplus of the amount of the intercompany profit. If the amounts of such fictitious intercompany profits are allowed to remain in New York's accounts, they may become real profits to the affiliated companies by improper inclusion as a part of the cost of service. The possible scope of the effects of such accounting as is here in question is further illustrated by the fact that transfers of property were made in both directions between New York and A. T. & T. at prices in excess of the net book cost of the respective transferor company, and accounted for in a manner similar to that employed with respect to the four transfers here in question. The result was that the combined surplus of the affiliated companies was increased, not because of any increase in income or property, not because of any change in the service rendered, but simply because of the accounting performed.

The passage of time can lend no sanction to improper accounting. Whenever errors in accounting are discovered they should be corrected. The inflationary write-ups found herein should never have been recorded in New York's accounts, and should now be forthwith eliminated from New York's accounts.

New York contends that the amounts paid to its parent company, A. T. & T., as a result of the acquisitions of telephone property here under consideration were fair and reasonable and were not in excess of the fair and reasonable value of the property acquired; that after reclassifying its accounts, as of January 1, 1937, as outlined above, appropriate amounts were entered in its Account 100.4 and the entries to operating expense accounts for

the purpose of amortizing amounts so included in Account 100.4 have been made in accordance with a plan approved by the Commission; and that therefore no other entries, and specifically no entry to its surplus Account 413, in the amount of $4,166,510.57 are required or appropriate under the Commission's Uniform System of Accounts. Respondent also asserts that the recording in its plant accounts of the full amounts paid to A. T. & T. was required by the accounting rules prescribed by the Interstate Commerce Commission, and in effect at the time of the respective prop-
41 erty acquisitions; and that since the "structural value" of the property, as measured by reproduction cost new less actual depreciation, was equal to or more than such amounts so paid, the "prices" were fair and reasonable.

All of these contentions ignore the important fact that New York was and is a wholly owned subsidiary of A. T. & T., and therefore fully subject to A. T. & T.'s control. This fact makes the fairness and reasonableness of the "prices" paid in such a transfer of property between such affiliated companies completely unrealistic as a measure of investment in plant. There was and could be no arms'-length bargaining between A. T. & T. and New York with respect to the amounts so paid. Any method of accounting which results in the inclusion in plant investment accounts of amounts based upon "values" agreed upon between a wholly owned subsidiary and its parent which are greater than legitimate net book cost to the transferor would nullify accounting from a regulatory standpoint. The full ultimate impact of such inflationary elements in the plant accounts is in time improperly reflected in the depreciation expense account as an alleged operating cost, unless, by proper regulatory requirements, the balance sheet is cleared, or in the first instance is kept free, of such inflationary elements. Accounting, for purposes of efficient regulation of public utilities, must be firmly grounded on the cost principle, and if the investment recorded in the accounts is to have some relationship to the actual investment dedicated to the public use by an affiliated group of companies, such agreed "values" must not be allowed to exist as a distortive element in their investment accounts. Certainly such "values" cannot be represented by an estimate of such an inherently speculative nature as reproduction cost less depreciation, or "structural value." Otherwise transfers of property between affiliated companies would provide a device to establish write-ups to any desired "structural value." "Structural value" at best requires conjecture, involving as it does estimates as to what certain property might have cost to reproduce, assuming it were to be reproduced in new
42 condition at the prices in effect at the time when the estimates are made; and further involving estimates as to

existing depreciation in the property, based on obsolescence and inadequacy, as well as wear and tear.[17]

The effects of using "structural value" as the basis for the property transfer may be illustrated by a comparison of book figures with the "structural value" figures for the two major transactions of the four considered herein, namely, the 1925 toll property transfer and the transfer of the instruments. Table D, below, shows such a comparison.

TABLE D.—*Comparisons of Book Cost, Reproduction Cost, and Depreciation Figures*

| | Toll lines (1925 transfer) | Instruments | Total |
|---|---|---|---|
| Book figures of A. T. & T.: | | | |
| Book cost of A. T. & T. | $5,010,340.49 | $8,135,224.98 | $13,145,565.17 |
| Depreciation Reserve | 801,858.95 | 3,980,944.73 | 4,782,803.68 |
| Net Book Cost | 4,208,481.24 | 4,154,280.25 | 8,362,761.49 |
| Appraisal for Transfer: | | | |
| Reproduction Cost | 6,693,499.53 | 8,326,548.64 | 15,020,048.17 |
| Depreciation Allowance | 861,614.75 | 1,665,309.73 | 2,526,924.48 |
| Net, or "Structural Value" | 5,831,884.78 | 6,661,238.91 | 12,493,123.69 |

In comparing the above figures, it will be observed that the reproduction cost of the toll lines exceeds book cost by more than 33 per cent, but that the depreciation allowance on the toll lines in the appraisal is only slightly greater in amount than the depreciation reserve accrued on the books of A. T. & T. In other words, the depreciation is relatively much lower in the appraisal than
43 on the books. In the case of the instruments, the depreciation allowance in the appraisal, despite its applicability to a higher base, is less than half the amount shown on the books. This may be explained by the fact that the book depreciation purports to take account of all causes of retirement, whether physical deterioration, obsolescence, inadequacy, or other cause, whereas the appraisal depreciation tends to be confined largely to observed physical deterioration.

It will also be observed in Table D above that the "structural value" of the toll lines, although representing depreciated property, is actually greater than the book cost new to A. T. & T. of the property. This means that where the "structural value" was

[17] The highly speculative nature of estimates of reproduction cost less depreciation is illustrated by the following defects in respondent's showings and offers of proof in this respect: The reproduction cost new figures were based in part upon prices of the Western Electric Company, Inc., another subsidiary of A. T. & T., without elimination of Western Electric profits. Such reproduction cost figures were based upon costs to A. T. & T., although in at least some instances construction costs of New York were lower.

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entered in the asset accounts of New York, the book cost of the property was written up, which accounted directly for a part of the inflation. The remainder of the inflation as to this property consists of the failure of New York to enter an appropriate credit in the depreciation reserve. With respect to the instruments, the amount entered by New York as book cost after the transfer was less than the book cost to A. T. & T. This means that as to the instruments, the entire inflation is represented not by an excess in the asset account but by the failure of New York to make due credit to its depreciation reserve. As previously found, New York made no credit to this reserve, with respect to the instruments.

New York attempts to justify the accounting followed by it with respect to the four property transfers involved herein on the ground that such accounting was required by accounting rules prescribed by the Interstate Commerce Commission and in effect at the time of the transfers. With respect to the toll property acquisitions, New York asserts that the accounting performed by it at the time was required by Instruction 13 [18] of the Inter-
44 state Commerce Commission's Uniform System of Accounts for Telephone Companies in effect from January 1, 1913, and that with respect to the acquisition of the telephone instruments, Instruction 10 [19] of the Uniform System of Accounts, as interpreted in Case No. 30 of Accounting Bulletin No. 11 issued by the Interstate Commerce Commission effective July 1, 1916, stated the required accounting.

New York's assertion that the accounting followed by it with respect to the four property transfers involved herein was required

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[18] Instruction 13 provided as follows:

"Plant and equipment and other property purchased.—When any property in the form of a going or completed plant is purchased, an appraisal of the property so acquired should be made, and the different constituent elements of the plant (and equipment, if any) or other property acquired should be appraised at their structural value; that is to say, at the estimated cost of replacement or reproduction less deterioration to the then existing conditions through wear and tear, obsolescence, and inadequacy. If the actual money value of the consideration given for the plant or other property was at the time of the acquisition in excess of such appraised value, the excess should be charged to account No. 204, Other Intangible Capital, and the appraised values of the constituent elements should be charged to the appropriate fixed capital accounts as hereinafter designated. If the actual money value of the consideration given was not in excess of such appraised value, such actual money value should be distributed through the said accounts in proportion to the said appraised value of the constituent elements appropriate to the respective accounts.

"Companies should be prepared to furnish the Commission, upon demand, a full report of the contract of acquisition, the consideration given therefor, the determination of the actual money value of such consideration if other than money, the appraisal, and the amounts charged to the respective accounts for each plant or other such fixed capital purchased. The purchaser is required to procure in connection with the acquisition of any such plant or other fixed capital all existing records, memoranda, and accounts in the possession or control of the grantor relating to the construction and improvement of such plant, and to preserve such record, memoranda, and accounts until authorized by law to destroy or otherwise dispose of them."

[19] Instruction 10 provided as follows:

"Costs to be actual money costs.—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount charged should be the actual money value of such consideration at the time of the transaction."

by accounting rules of the Interstate Commerce Commission in effect at the time is not supported by the record. There is no provision in Instruction 10 or Instruction 13, or elsewhere in the Interstate Commerce Commission's Uniform System of Accounts for Telephone Companies in effect at the time, which specifically required or authorized the recording of property acquisitions from affiliates at any amount greater than the net book investment of the transferring affiliate. The four property transfers in-
45 volved herein were never submitted to the Interstate Commerce Commission for a ruling as to the propriety of the accounting performed, and no ruling was ever given by that Commission or its responsible accounting officials with respect to such accounting. As early as 1914, however, shortly after the effective date of the Interstate Commerce Commission's Uniform System of Accounts, the New England Telephone and Telegraph Company, an A. T. & T. subsidiary, and A. T. & T. requested rulings by the Interstate Commerce Commission as to whether Instruction 13 of the Interstate Commerce Commission's Uniform System of Accounts applied to the accounting for transfers of property between affiliated companies of the Bell System, the companies contending that it did not. The Interstate Commerce Commission replies stated specifically that Instruction 13 was not applicable to the affiliated company transfers submitted to it. Mr. C. D. Crandall, present Director of the I. C. C. Bureau of Accounts, and a member of that Commission's accounting staff for many years prior to 1925, confirmed the position of the Interstate Commerce Commission as stated in such correspondence. In numerous subsequent cases, the question of the propriety of the accounting to be performed with respect to similar property transfers between Bell System affiliated companies, including transfers to and from New York itself, was submitted to the Interstate Commerce Commission for ruling. Testimony presented by New York showed that in the period 1913 to 1932, both years inclusive, there were approximately 300 property transfers between Bell System affiliated companies involving a charge to the telephone plant account of $50,000 or more; and that of these, approximately one-half were accounted for on the basis of a transfer of the book figures from the books of the transferor to those of the transferee, the remainder being accounted for on the basis of the "price" assigned for the property transferred. It was further testified that in every case in which the transfer was accounted for on the book figure basis, which included some cases of property transfers to or from New York, some of these being in the very period when the trans-
46 fers involved herein were being undertaken, the question of the propriety of this accounting was submitted to the Interstate Commerce Commission, and, without exception, written ap-

proval of such accounting was given by the responsible accounting officials of that Commission. The Bell System companies involved proceeded with their accounting on the basis of such approval. In these cases, as previously indicated, the Bell System companies urged the approval of the accounting on the basis of the transferor's book figures. In no case in which the property transfer was accounted for by the transferee on the basis of the cost to it, that is, the "price" fixed for the property (which might or might not have been equivalent to "structural value"), was the question of the accounting to be performed submitted to the Interstate Commerce Commission.

This Commission does not understand that it would be bound by such an accounting requirement of the Interstate Commerce Commission as that which New York contends herein to have existed.[20] In any event, however, this Commission is unable to find that such an accounting requirement did exist. To summarize findings set forth above, the Interstate Commerce Commission, in every case of about 150 submitted to it involving a charge to plant accounts of $50,000 or more, approved an accounting for the property transfer between Bell System affiliated companies on the basis of the transferor's book figures; and in no case did that Commission rule on the accounting by the transferee for a property transfer between Bell System affiliated companies which was on the basis of cost or "price" to the transferee. It further appears from the letters on behalf of the Bell System companies to the Interstate Commerce Commission submitting the question of the accounting for the Bell System transfers that those companies, including New York, recognized the soundness of accounting for such transfers on the basis of the transferor's book figures as
47 to the plant investment and related reserves. This Commission is unable to conclude that the above-cited Instructions 10 and 13 of the Interstate Commerce Commission's Uniform System of Accounts, with their emphasis on "actual money costs" or "actual money value," and the express application to property "purchased," were intended to apply to the accounting for transfers of property between affiliated companies in which there were mere record changes of ownership. This Commission is impelled to reject this conclusion particularly because it is unable to conclude that the Interstate Commerce Commission intended to sanction, or that the provisions of its Uniform System of Accounts did

[20] In Section 604 (a) of the Communications Act of 1934, as amended, it is recognized that this Commission may modify, terminate, supersede, or repeal any order, determination, rule, regulation, etc., of the Interstate Commerce Commission with respect to matters transferred by the Act from the jurisdiction of that Commission to this Commission, and such matters include jurisdiction over telephone accounting.

sanction, in any way any write-ups of asset accounts and inflation of surplus within an affiliated system.[21]

New York asserts that even if there were inflationary write-ups in connection with the four property transfers involved herein, as amounts in its accounts with respect to the property which was acquired from A. T. & T. have been retired from New York's plant accounts, the related amounts of the inflationary write-ups have been removed from its accounts, and that to that extent, charges to surplus are not now necessary or appropriate to eliminate such amounts. It is clear, however, that the inflation still remains in New York's books either in its assets accounts or
48 as a deficiency in its depreciation reserve account, or a combination of both. When New York retired portions of the property acquired from A. T. & T., New York's book cost was credited to its plant accounts, the same cost (aside from the effect of salvage) was debited to the depreciation reserve, and the resultant change in net book cost of plant was zero. Thus the effect of retiring an inflationary asset item was to create a deficiency in the depreciation reserve equal to the inflation formerly existing in the asset account. The deficiency in New York's depreciation reserve therefore results from the existence of debits made thereto and included therein in recording the retirement of portions of the acquired property in amounts in excess of the net book cost to A. T. & T. of such property. These debit amounts were included in New York's depreciation reserve account despite the fact that insufficient credits had been made to such reserve accounts for purposes of retirement of the property.

New York attempted to counter these conclusions with the contention that its depreciation reserve *as a whole* is now in excess of requirements and consequently the inflation introduced through the accounting for the transactions in question has been offset by an excess in the reserve resulting from other causes; and that,

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[21] It is of interest to note that the Uniform System of Accounts for Telephone Corporations prescribed by the New York Public Service Commission, effective January 1, 1912, as amended on March 17, 1921, contained the following provision (Section 7 of the General Instructions:

"Plant and equipment and other property purchased.—When any telephone line or part thereof (excepting new or used material and supplies) is purchased for a lump sum, an appraisal of the property so acquired shall be made, classifying the various constituent elements in the property according to the accounts prescribed by this Commission in its Uniform System of Accounts for Telephone Corporations. The actual money value of the consideration given for the plant or other property purchased shall be distributed to such accounts in accordance with the appraisal, but in no case shall the values assigned to tangible fixed capital accounts exceed the cost of reconstructing such plant and equipment at prices in effect at the time of purchase, *and when there is substantial identity of interest between the vendor and the vendee the values assigned to tangible fixed capital accounts shall not exceed the original cost of such property to the vendor. The estimated accrued depreciation on property purchased shall be set upon the books of the vendee as an offsetting liability to the cost of property so acquired.* * * * [Italics supplied.]

further, unless the Commission can show that the reserve as a whole is deficient no correcting entry which would increase the reserve can be required. But the question as to whether the depreciation reserve, taken as a whole, is adequate is irrelevant to the issues herein. No challenge is here being made to the adequacy of the depreciation reserve as a whole. This line of argument represents an attempt to offset one error by another. If New York's depreciation reserve is in excess of requirements, it means that New York has been making excessive charges to operating expenses for depreciation. A forgiveness of the 1925–1928 write-ups on the ground of their elimination by charges against the depreciation reserve would be the equivalent of permission to
49 establish corporate surplus out of accruals charged to operating expenses by a company under the guise of depreciation. New York is actually here trying to justify a transfer from its depreciation reserve to the corporate surplus of its parent, A. T. & T. New York's further contention, stated, above, is in effect a claim that it can make any improper entries which would reduce its depreciation reserve, and not be required to correct such entries unless a deficiency can be proved in the reserve as a whole. This amounts to a claim, about which no more need be said, that no individual accounting entries can be ordered to be corrected unless the Commission can prove that all the accounts involved are otherwise in order.

New York relies heavily on statements of the United States Supreme Court in American Telephone and Telegraph Company v. United States, 299 U. S. 232, and the record in that case, with respect to the disposition of items in Account 100.4. In this line of argument, however, New York assumes that the amounts in question were properly includible in Account 100.4 when it reclassified its accounts in 1937. Since the entries made at the time of the four property transfers involved herein were improper, New York should have eliminated them and corrected its books before reclassifying its accounts in 1937. The part played by the new Uniform System of Accounts effective in 1937, and the reclassification requirements thereunder, was simply to call attention to an impropriety is accounts which should have been corrected even if the new system had not gone into effect. But if it were assumed, for the sake of argument, that the amounts in question were properly includible in Account 100.4, the Commission is unable to find from the circumstances any sound basis for concluding that the amounts of inflationary write-ups which occurred here in the accounting for property transfers between affiliated companies "represent an investment which the accounting company had made in assets of continuing value," or are "definitely

attributable to depreciable telephone plant," within the
50 meaning of the statement filed by the government with the
Supreme Court in the above-cited American Telephone and Telegraph Company case.[22]

New York has suggested that the separate creditors of the respective affiliated companies involved in a property transfer may suffer if any amount paid by the transferee over the net book cost to the transferor is required to be charged by the transferee to its surplus accounts. We find no merit in this suggestion. This report is not concerned with the prudence of the transfers, but only with the accounting to be followed therefor. The question of the prudence of the transactions would appear to be one between the creditors and the debtor companies. From the accounting standpoint, the requirement that property transferred between affiliates be recorded on the books of the transferee at net book cost to the transferor should serve as a restraint to the kind of speculative financing which has no place in a properly conducted public utility enterprise.

New York contends that it was denied a fair hearing. The record will show, however, that New York was given a full and fair hearing on the real issues. New York's complaint is actually that it was not permitted to flood the record with voluminous data irrelevant to the real issues. Thus, New York attempted repeatedly to present data as to the justification for the acquisition of the properties to which the accounting here in question related, the appraisal methods used, and the adequacy of the depreciation reserve as a whole. Many of these data was introduced into the record, but the presiding Commissioners eventually ruled
51 that no further testimony along these lines would be received. The irrelevance of such matters to the issues herein is clearly demonstrated in this report. It is clear from an examination of the record that no competent and material evidence concerning the real issues in this proceeding was rejected.

New York's amortization of the debit amounts included in its Account 100.4 by charges to its operating expense accounts, and its amortization of the credit amounts included in that account

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[22] In view of the conclusion that the amounts here in question were not includible in Account 100.4, it is unnecessary to rule on the propriety of the accounting performed by New York on its assumption that Account 100.4 was to be used for the acquisition here in question. We point out, however, that Account 100.4 and the method to be followed under the System of Accounts in reclassifying the accounts with respect to property acquisitions, as outlined by Section 31.2–21 of the accounting Rules and Regulations of this Commission, specifically require that the amounts includible in Account 100.4 shall reflect the difference between (1) the original cost, after deduction of the appropriate reserve requirements for depreciation and amortization, and (2) the amounts paid. No distinction is made in the accounting rules as between acquisitions prior to January 1, 1937, and those after that date. Even on New York's assumption that Account 100.4 was to be used here, New York's failure to make any credit entries to Account 171 to reflect the reserve requirement for depreciation of acquired property, and to deduct the amount of such reserve requirement from original cost, in determining the amounts includible in its Account 100.4 resulted in the inclusion of insufficient amounts in that account.

by credits to its operating expense accounts, were begun in 1938 without any prior direction, authorization, or approval having been given to New York by this Commission. Such action was improper, even on the basis of New York's assumption that the amounts being so amortized were properly includible in Account 100.4. Subsection (c) of Account 100.4 requires that the amounts included in that account be disposed of, written off, or amortized as directed by the Commission. Account 614, the operating expense account to which such amortization charges and credits were made by New York, permits such charges or credits only when authorized by the Commission.[23] On July 12, 1939, the Commission adopted its Order No. 60 in which the Commission allowed all telephone companies to dispose of any debit amounts includible in Account 100.4 by charges to surplus, or by amortization over a reasonable period through charges to Account 323, "Miscellaneous income charges,"[24] without further direction or approval by the Commission. This order, however, also directed companies desiring another manner of disposition of such debit amounts to request "that the Commission approve the recommended disposition or direct appropriate disposition according to the circumstances involved in each transaction." Disposition of credit amounts was ordered to be "as the Commission may approve or direct."
52 Appropriate reservation was made to require subsequent disposition by charges to surplus or to alter the previously determined amortization periods.[25]

New York argues on the basis of correspondence between A. T. & T. and the Commission's staff that its amortization through operating expenses of amounts included in its Account 100.4 was performed pursuant to "tentative approval of the Commission," claiming specifically "that the Commission gave its approval to such amortization subject to the right reserved to it to order a different disposition of the amounts included in Account 100.4 if, upon subsequent inquiry, it should appear that other treatment would be appropriate." New York asserts, however, that the primary question now is whether or not such approval should have been given.

The Commission finds that no direction, authorization or approval has ever been given to New York by this Commission to

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[23] Account 614 reads as follows: "§ 31.614 Amortization of telephone plant acquisition adjustment.—This account shall be charged or credited each month with such amounts as may be authorized by the Commission to be included in operating expenses under a plan to amortize accounts in Account 100.4, 'Telephone plant acquisition adjustment.' Amounts so entered shall be charged or credited, as appropriate, to Account 172, 'Amortization reserve.'"

[24] Section 31.323 of the Commission's Rules and Regulations.

[25] Case 10, Accounting Circular No. 5 (August 16, 1939), Accounting Bulletin No. 1, of this Commission, also made it clear that net amounts in Account 100.4 resulting from debit and credit amounts relating to different transactions, could not be disposed of without direction or approval by the Commission.

dispose of amounts in Account 100.4 by amortization through charges or credits to Account 614, or any other operating expense account. As our findings herein show, no such direction, authorization, or approval would have been appropriate as to the property transfers considered in this report. Since the Commission's order of June 16, 1942, herein, suspending all amortizing charges to operating expenses with respect to amounts in New York's Account 100.4, New York has not submitted any data as to the propriety and reasonableness of such charges, other than those submitted herein regarding the three toll property transfers. We find that the amortization through operating expenses of the amounts included in New York's Account 100.4, which amortization was begun by New York in 1938, was in violation of the Commission's Accounting Rules and Regulations, particularly Subsection (c) of Account 100.4, Account 614, and Order No. 60. Such amortization entries as related to the amounts included in New York's Account 100.4 with respect to the property transfers involved herein were there-
fore improper for such reason, as well as for the reasons
53 previously set forth in this report. Complete rectification
of such amortization entries between 1938 and January 1, 1942, by reversal thereof, will not be required because the amounts involved are relatively insignificant and the accounts for that period have been closed. The suspension by the Commission's order of June 16, 1942, herein, of amortizing charges to operating expense accounts made by New York on and after January 1, 1942, with respect to the remaining amounts included in New York's Account 100.4 should be continued, pending submission of proof by New York of the propriety and reasonableness of such charges, and the direction, authorization, or approval of the Commission. Considering, however, all the circumstances surrounding such violation, and the entries herein required to be made by New York, the Commission is of the opinion that no further action by it with respect to such violation is required, and the investigation directed thereto will be terminated and dismissed.

## Conclusions

We are of the opinion and we find and conclude that:

(1) Respondent has failed to show that the amount of $4,166,-510.57 should not be charged to its Account 413, with concurrent entries to appropriate accounts; and we further find and conclude that such amount shall be charged (debited) to its Account 413;

(2) Concurrently with such charge to Account 413, entries shall be made (a) to eliminate, by appropriate entries to respondent's

Account 100.4, the amounts presently included in that account, associated with New York's acquisitions from A. T. & T. on November 1, 1925, September 1, 1926, and December 31, 1928; (b) to eliminate the amounts presently included in Account 172, associated with such acquisitions, with contra entries to Account 171; (c) to adjust the balances in Account 100.1, and the related primary plant Account 231, "Station apparatus," to reflect the original cost of the surviving telephone instruments acquired by
54 New York from A. T. & T. on December 31, 1927; by debits to those accounts in the amount of the difference between such original cost and the surviving amounts recorded in such Accounts; and (d) to adjust the balance in Account 171, to reflect appropriately the elimination of the inter-company profit or write-up of $4,166,510.57 resulting from the accounting performed by New York at the time of and during the period since such acquisitions, with respect to and as a result of such acquisitions, by credits to that account equal to the difference between the amounts debited to Account 100.1 and Account 413, and the amounts credited to Account 100.4;

(3) Respondent has violated the Commission's Accounting Rules and Regulations by making unauthorized entries in its accounts for the purpose of amortizing through charges and credits to its operating expense accounts amounts it has included in its Account 100.4; but under the circumstances, other than the entries required herein, no further action by the Commission with respect thereto is required, and the investigation with respect to such violation by respondent, its officers and directors, shall be terminated and dismissed;

(4). All charges which respondent has made to its operating expense accounts for the purpose of, or in conjunction with, amortizing or otherwise disposing of all amounts included in its Account 100.4, other than those included therein with respect to the three toll property acquisitions from A. T. & T. in 1925, 1926, and 1928, shall continue to be suspended, and respondent shall cease and desist from making any such charges to its operating expense accounts, pending submission of proof by respondent of the propriety and reasonableness of such charges, and the specific direction, authorization, or approval of the Commission.

An appropriate Order will issue.

FEDERAL COMMUNICATIONS COMMISSION,
(Sgd.) T. J. SLOWIE,
T. J. Slowie, *Secretary*.

Adopted December 14, 1943.

55 Before the Federal Communications Commission, Washington, D. C.

Docket No. 6329—P-30

IN THE MATTER OF NEW YORK TELEPHONE COMPANY, ACCOUNTING

ORDER

At a session of the Federal Communications Commission held at its offices in Washington, D. C., on the 14th day of December 1943;

The Commission, having under consideration the record of the proceedings herein, including its Proposed Report herein adopted June 22, 1943, the exceptions and arguments with respect thereto; and having this day adopted its Report herein;

It is ordered, That the Report of the Commission adopted this day in this proceeding be, and it is hereby made a part hereof by reference;

It is further ordered, That:

(1) The New York Telephone Company shall charge (debit) the amount of $4,166,510.57 to its Account 413, "Miscellaneous Debits to Surplus";

(2) The New York Telephone Company shall, concurrently with such charge to Account 413, make entries (a) to eliminate, by appropriate entries to its Account 100.4, "Telephone Plant Acquisition Adjustment," the amounts presently included in that account, associated with the New York Telephone Company's acquisition from the American Telephone and Telegraph Company on November 1, 1925, September 1, 1926, and Decem-
56 ber 31, 1928; (b) to eliminate the Amounts presently included in Account 172, "Amortization Reserve," associated with such acquisitions, with contra entries to Account 171, "Depreciation Reserve"; (c) to adjust the balances in Account 100.1, "Telephone Plant in Service," and the related primary plant Account 231, "Station Apparatus," to reflect the original cost of the surviving telephone instruments acquired by the New York Telephone Company from the American Telephone and Telegraph Company on December 31, 1927, by debits to those accounts in the amount of the difference between such original cost and the surviving amounts recorded in such accounts; and (d) to adjust the balance in Account 171, to reflect appropriately the elimination of the inter-company profit or write-up of $4,166,510.57 resulting from the accounting performed by the New York Telephone Company at the time of and during the period since such acqui-

sition, with respect to and as a result of such acquisitions, by credits to that account equal to the difference between the amounts debited to Account 100.1 and Account 413, and the amounts credited to Account 100.4;

(3) The New York Telephone Company shall correct its books and records as of December 31, 1941, by placing thereon the following entries:

| Entry No. 1 | Debit | Credit |
|---|---|---|
| 100.1 Telephone Plant in Service (Account 231, Station Apparatus) | $194, 886. 97 | |
| 100.4 Telephone Plant Acquisition Adjustment | | $481, 439. 60 |
| 171 Depreciation Reserve | | 3, 879, 957. 94 |
| 413 Miscellaneous Debits to Surplus | 4, 166, 510. 57 | |

This entry made in accordance with the order of the Federal Communications Commission dated December 14, 1943, in Docket No. 6329.

| Entry No. 2 | Debit | Credit |
|---|---|---|
| 171 Depreciation Reserve | | $333, 559. 21 |
| 172 Amortization Reserve | $333, 559. 21 | |

This entry made in accordance with the order of the Federal Communications Commission dated December 14, 1943, in Docket No. 6329.

57 (4) The New York Telephone Company shall make any necessary entries to adjust entries reflecting transactions subsequent to December 31, 1941, and to adjust between Account 231, "Station apparatus," and Account 122, "Material and Supplies," as may be required to be consistent with the entries required by the above provisions of this order.

(5) All charges which the New York Telephone Company has made to its operating expense accounts for the purpose of, or in conjunction with, amortizing or otherwise disposing of all amounts included in its Account 100.4 other than those included therein with respect to the toll property acquisitions dated November 1, 1925, September 1, 1926, and December 31, 1928, shall continue to be suspended, and respondent shall cease and desist from making any such charges to its operating expense accounts, pending submission of proof by respondent of the propriety and reasonableness of such charges, and the specific direction, authorization, or approval of the Commission;

It is further ordered, That the investigation instituted by the Commission's order of June 16, 1942, herein, to determine whether respondent or any of its officers or directors has violated certain of the Commission's accounting rules and regulations be, and it is hereby terminated and dismissed;

It is further ordered, That the New York Telephone Company shall within 60 days from the service of this order submit verified proof that the journal entries required herein have been made.

It is further ordered, That the New York Telephone Company shall within 40 days from the service of this order notify this Commission in writing whether this order and all of its terms and requirements are accepted and will be obeyed.

By the Commission.

(Sgd.) T. J. SLOWIE,
T. J. Slowie, *Secretary.*

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58 *Exhibit B to complaint*

District Court of the United States, Southern District of New York

In Equity No. 81-366

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, ET AL., PLAINTIFFS

*v.*

THE UNITED STATES OF AMERICA ET AL., DEFENDANTS

EXTRACTS FROM FINDINGS OF FACT OF THE DISTRICT COURT, FILED MARCH 24, 1936

III

Telephone Division Order No. 7-C requires plaintiffs to include in the telephone plant accounts the "original cost" of their telephone plant, and provides that the difference between said original cost and cost to the accounting company of property acquired from another public utility shall be recorded on their books in other specified investment accounts.

IV

Plaintiffs have heretofore performed accounting with respect to property acquired from other public utilities which resulted in the inclusion in their telephone plant accounts of amounts representing various costs, such as current cost new, actual cost to plaintiffs, structural value, or cost to the predecessor company (by merger of book accounts). The Uniform System of Accounts prescribed by Telephone Division Order No. 7-C requires that in accounting for property acquired from another public utility, and in all other instances, plaintiffs' telephone plant accounts shall be stated on a uniform basis, that being "original cost," as therein defined.

59

## V

Telephone Division Order No. 7–C does not require that the recorded cost or investment of the plaintiffs in property theretofore acquired by them from another public utility be obliterated or eliminated from their investment accounts, but merely requires plaintiffs to segregate the element of recorded cost or investment into the following investment accounts:

100.1 Telephone plant in service.
100.2 Telephone plant under construction.
100.3 Telephone property held for future telephone use.
100.4 Telephone plant acquisition adjustment.

## VI

Telephone Division Order No. 7–C further requires plaintiffs to include in their investment accounts the amount which they actually pay for property acquired on and after January 1, 1936, from other public utilities.

## VII

Telephone Division Order No. 7–C requires plaintiffs to segregate in an account numbered 100.4 and entitled "Telephone plant acquisition adjustment," the difference between (a) the amount of money which they actually paid for telephone plant acquired and (b) the original cost of such plant less the amounts of reserve requirements for depreciation and amortization of the property acquired and amounts of contributions to the predecessor company or companies for the construction and acquisition of such property.

60

## VIII

The plaintiffs are not prevented by Telephone Division Order No. 7–C from recovering amounts included in Account 100.4 in view of the alternative provisions of paragraph (C) of the text of said Account 100.4, which make provision for the amortization or other appropriate disposition of amounts included in Account 100.4. The Commission has made no direction with respect to the disposition of any such amounts.

## IX

Telephone Division Order No. 7–C requires that plaintiffs' accounts shall be kept on a basis which will reflect the facts with

respect to their transactions and which will show their actual condition for the information of all persons interested therein, except with respect to contributions to predecessor utilities and depreciation of property held for future telephone use, and said order is capable of practical application except with respect to contributions to predecessor utilities.

X

Telephone Division Order No. 7–C does not prevent plaintiffs from recording in their expense accounts the expense of depreciation which they actually incur, except that said order does not provide for depreciation of the classes of depreciable property, the original cost of which is includible in Account 100.3, "Property held for future telephone use."

XI

Telephone Division Order No. 7–C does not require plaintiffs to write off any portion of their actual investment where
61 they have paid a price in excess of original cost, but merely requires a segregation of this actual cost into certain investment accounts, all of which will appear in the balance-sheet statements of plaintiffs; and no writing off is required by the provisions of Order No. 7–C when plaintiffs purchase property in the future, but only a segregation of such cost is required.

XII

Telephone Division Order No. 7–C does not require plaintiffs to make radical or retroactive changes in their completed accounts. In this respect said order merely requires the reclassification of balances as of its effective date in certain balance-sheet accounts.

XIII

Telephone Division Order No. 7–C does not require that amounts recorded in Account 100.4 be disposed of, written off, or amortized by plaintiffs. The form of the accounting to be performed is dependent upon the development of facts in connection with each individual acquisition. Said order merely provides for alternative modes of disposition adaptable to the facts of individual acquisitions.

62 *Exhibit C to complaint*

In the Supreme Court of the United States

October Term, 1936—No. 74

AMERICAN TELEPHONE AND TELEGRAPH CO., ET AL., APPELLANTS

*v.*

THE UNITED STATES OF AMERICA, FEDERAL COMMUNICATIONS COMMISSION, AND NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

On Appeal From the District Court of the United States for the Southern District of New York

SUPPLEMENTAL MEMORANDUM BY THE UNITED STATES AND THE FEDERAL COMMUNICATIONS COMMISSION

The Federal Communications Commission construes the provisions of Telephone Division Order No. 7-C, issued June 19, 1935, pertaining to account 100.4, as follows:

(1) That amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provision will be made for their amortization.

63 (2) That when amounts included in account 100.4 are deemed, after a fair consideration of all the circumstances, to be definitely attributable to depreciable telephone plant, provision will be made for amortization of such amounts through operating expenses, through the medium of either account 613 (R. 186) or account 675 (R. 205).

The Commission believes that the foregoing construction of its order is that which it presented to the District Court through the affidavits of its witnesses.

Respectfully submitted.

STANLEY REED,
*Solicitor General,*
JOHN DICKINSON,
*Assistant Attorney General,*
HAMPSON GARY,
*General Counsel,*
*Federal Communications Commission.*

November —, 1936.

64 *Exhibit D to complaint*

60940

Before the Federal Communications Commission, Washington, D. C.

Docket No. 6329

IN THE MATTER OF NEW YORK TELEPHONE COMPANY ACCOUNTING

ORDER

At a session of the Federal Communications Commission held at its offices in Washington, D. C., on the 16th day of June 1942;

It appearing, That on November 1, 1925, September 1, 1926, and December 31, 1928, New York Telephone Company acquired certain telephone property from the Long Lines Department of American Telephone and Telegraph Company, its parent company; and that the amounts paid to American Telephone and Telegraph Company by New York Telephone Company for such property were $1,659,551.91 in excess of the book cost, as retired, less the related depreciation and amortization reserves, as reflected on the books of the Long Lines Department of American Telephone and Telegraph Company;

It further appearing, That on December 31, 1927, the New York Telephone Company acquired certain telephone instruments (receivers, transmitters, and induction coils) from American Telephone and Telegraph Company; and that the
65 amount paid to American Telephone and Telegraph Company by New York Telephone Company for such instruments was $2,506,958.66 in excess of the book cost less the related depreciation reserve, as reflected on the books of American Telephone and Telegraph Company; and

It further appearing, That as a result of the accounting performed by New York Telephone Company at the time of and since the respective dates of the acquisitions of telephone property, referred to above, an insufficient amount is included in its Account 100.4, "Telephone plant acquisition adjustment;" and that since the effective date, January 1, 1937, of the Commission's Uniform System of Accounts for Class A and Class B Telephone Companies, New York Telephone Company has made, and is continuing to make, charges to operating expense accounts for the purpose of amortizing or otherwise disposing of amounts included in its Account 100.4, without prior direction, authorization, or approval by this Commission;

It is ordered, That an investigation be, and the same is hereby, instituted into the accounting performed and the accounts, records, and memoranda kept by New York Telephone Company at the time of and during the period since its several acquisitions of telephone property, with respect to and as a result of such acquisitions;

It is further ordered, That New York Telephone Company be, and it is hereby, made respondent to this proceeding; and that said respondent shall show cause, under oath, why the total amount of $4,166,510.57, representing amounts paid to American Telephone and Telegraph Company by the respondent for telephone property acquired from American Telephone and Telegraph Company by the respondent for telephone property acquired from American Telephone and Telegraph Company on November 1, 1925, September 1, 1926, December 31, 1927, and December 31, 1928, in excess of book cost less the related depreciation and amortization reserves, as reflected on the books of American Telephone and Telegraph Company and its Long Lines Department,
66 should not be charged to New York Telephone Company's Account 413, "Miscellaneous debits to surplus," with concurrent entries to such accounts as may be appropriate in the light of the accounting performed at the time of and since the respective dates of the acquisitions of such telephone property;

It is further ordered, That all charges to operating expense accounts which have been made by the respondent on and after January 1, 1942, for the purpose of, or in conjunction with, amortizing or otherwise disposing of amounts included in its Account 100.4 be, and they are hereby, suspended pending submission of proof by the respondent of the propriety and reasonableness of such charges; and that the respondent shall cease and desist from making any such charges to operating expense accounts, pending submission of such proof, unless otherwise specifically directed by the Commission;

It is further ordered, That an investigation be, and the same is hereby, instituted to determine whether the respondent company or any of its officers and directors have violated the provisions of Account 100.4, Subsection (C) (Section 31.100.4, Rules and Regulations), and of Account 614 (Section 31.614, Rules and Regulations), of the Commission's Uniform System of Accounts for Class A and B Telephone Companies; Commission Order No. 60, adopted July 12, 1939; and Section 220 (g) of the Communications Act of 1934;

It is further ordered, That a hearing on the above matters be held in the office of the Public Service Commission of New York, State Office Building, 80 Centre Street, New York, New York, beginning at 10:00 a. m., on the 30th day of July, 1942, and that

on or before fifteen days from the date of service of this order the respondent and each of its officers and directors shall file with the Commission its and their respective verified answers to this order;

It is further ordered, That the hearing provided for by this order shall be conducted jointly with any hearings
67 involving similar matters which may be ordered for the same time and place by the Public Service Commission of New York and the Connecticut Public Utilities Commission; and that copies of this order shall be served upon the respondent and each of its officers and directors, the Public Service Commission of New York, the Connecticut Public Utilities Commission, the Massachusetts Department of Public Utilities, the Vermont Public Service Commission, the Pennsylvania Public Utility Commission, the New Jersey Board of Public Utility Commissioners, and the National Association of Railroad and Utilities Commissioners.

By the Commission.

(Sgd.) T. J. Slowie,
T. J. SLOWIE,
*Secretary.*

68 *Exhibit E to complainant*

Before the Federal Communications Commission

Docket No. 6329

IN THE MATTER OF NEW YORK TELEPHONE COMPANY, ACCOUNTING

The New York Telephone Company, respondent herein, for its answer to the order of the Federal Communications Commission dated June 16, 1942, upon information and belief:

First. Admits each of the allegations of the first paragraph of the order except that it does not admit that the related depreciation and amortization reserves as reflected on the books of the Long Lines Department of the American Telephone and Telegraph Company therein referred to were as stated in said paragraph and denies that any separate reserve was set up on the books of the American Telephone and Telegraph Company for the particular property in question or for the class of property to which it belonged, but admits that the figures stated in said paragraph are correct upon the basis of an estimated allocation of the book reserves of the American Telephone and Telegraph Company made by that Company. In connection with the foregoing admissions and denials the respondent alleges and explains that the reserves referred to in said paragraph are irrelevant insofar as the trans-

action referred to may be in anywise subject to the present system of accounts, as that system deals only with reserve requirement and not with vendor's book reserves.

69 Second. Admits each of the allegations contained in the second paragraph of the said order except that it does not admit that the related depreciation and amortization reserves as reflected on the books of the American Telephone and Telegraph Company therein referred to, were as stated in said paragraph but admits that the said American Telephone and Telegraph Company did maintain a reserve for instruments generally and that the figures set forth in paragraph 2 are correct upon the basis of an estimated allocation of the book reserves of American Telephone and Telegraph Company made by that Company. Furthermore, in connection with the foregoing admissions and denials the respondent alleges that the reserves referred to in said paragraph are irrelevant in so far as the transaction referred to may be in anywise subject to the present system of accounts as that system deals only with reserve requirement and not with vendor's book reserves.

Third. Denies each of the allegations contained in the third paragraph of said order.

Fourth. In connection with and in explanation of all of the foregoing admissions and denials, respondent alleges as follows:

(a) The amounts paid to the Long Lines Department of the American Telephone and Telegraph Company for the property purchased from it on November 1, 1925, September 1, 1926, and December 31, 1928, and referred to in the first paragraph of the said order of this Commission were not in excess of the fair and reasonable value of said property at the respective times of purchase.

(b) That the reason for the said transfer was as follows:

The American Telephone and Telegraph Company withdrew from intrastate toll business within the State of New York
70 and respondent withdrew from certain interstate toll business. Because of the foregoing, the respondent needed the plant in question and the American Telephone and Telegraph Company no longer required the same.

(c) The amounts paid to the Long Lines Department of American Telephone and Telegraph Company were not in excess of the fair value of said physical property or of the reproduction cost new thereof less actual depreciation.

(d) At the times of said purchases the respondent was subject to the authority and jurisdiction of the Interstate Commerce Commission and said transactions were recorded on the books of account of respondent in accordance with the accounting rules and practices prescribed by it.

(e) The prices paid by respondent for said properties purchased in 1925 and 1926 were attacked by the Public Service Commission of the State of New York and The City of New York in the rate case brought by respondent against the New York Public Service Commission in April 1924, in the United States District Court, Southern District of New York (in Equity 29-126), the trial of which case was not concluded until October 1928, were litigated therein, and the said Court sustained the reasonableness of said transaction and included said property in respondent's rate base at the price paid for it, and respondent submits that it should not be required to litigate again the matter of the value of said property.

(f) Approximately half of the said property purchased in 1925, 1926, and 1928 had been retired from service prior to January 1, 1937, the effective date of the present system of accounts. The entire price paid for that which remained in service in January 1937 did not constitute more than four-tenths of one per cent. of respondent's plant account. The price of that now remaining in service is still less.

(g) Respondent by fair and reasonable methods determined what portions of the property purchased from the American
71 Telephone and Telegraph Company in 1925, 1926, and 1928 and referred to in the said order of this Commission of June 16, 1942, were still in service in January 1937, determined the "original cost" thereof, retained only that portion of its actual or book cost in Account 100.1, and transferred the balance by appropriate entries from Account 100.1 to Account 100.4. This Commission was informed of the amounts so transferred and the method followed in arriving at the same, and no exception was taken thereto by it for more than four years.

(h) After setting up said Account 100.4 respondent proceeded to amortize amounts included therein, including the amounts referred to in (g) above, concerning which this Commission was informed by the American Telephone and Telegraph Company and such amortization respondent then understood met with the approval of this Commission.

(i) As appears from (a), (b), (c), (d), and (e) above, the property above discussed was worth as much as or more than the price paid for it, was useful and necessary to respondent and represents an investment which respondent "made in assets of continuing value," and an investment "definitely attributable to depreciable telephone plant," within the meaning of those words as used in stipulation filed by this Commission with the United States Supreme Court in November 1936 in case of American Telephone and Telegraph Company v. Federal Communications Commission.

(j) With respect to the allegation in the third paragraph of the order that an insufficient amount is included in respondent's Account 100.4, respondent alleges that under the Uniform System of Accounts and binding constructions thereof by this Commission, no figure for reserve requirement was, or should have been, entered in the depreciation reserve with a corresponding entry in Account 100.4.

(k) With respect to the purchase of instruments in December 1927, the price paid by the respondet to the American Telephone and Telegraph Company for said instruments was a fair
72 and reasonable one and the amount set up in the plant accounts of this respondent was not in excess of the value of the property acquired and the manner in which it was accounted for was in accordance with the system of accounts of the Interstate Commerce Commission in force and effect at the time when the transaction took place.

(l) The price paid by respondent for said instruments was attacked by the Public Service Commission of the State of New York and The City of New York in the case of New York Telephone Company against the Public Service Commission of the State of New York (in Equity 29–126), above referred to, was litigated therein, and the court sustained the reasonableness of said transaction and included said instruments in respondent's rate base at the price paid for them, and the respondent submits that it ought not to be required to litigate again the matter of the value of said instruments.

Fifth. Answering the order to show cause why an amount equal to \$4,166,510.57 should not be charged to Account 413, Miscellaneous Debits to Surplus with concurrent entries to such accounts as may be appropriate in the light of the accounting performed at the time of and since the respective dates of the acquisitions of the telephone property referred to in paragraphs 1 and 2 of the order, respondent alleges as follows:

1. As above stated, the transactions were fair and proper transactions at the time when made.

2. They were properly recorded on the books of the respondent according to the system of accounts which was in effect at the time of such transactions.

3. With respect to the purchase of the instruments, nothing in the accounting provisions of the Uniform System of Accounts prescribed by this Commission requires any change in the accounts of the respondent.

4. With respect to the purchases referred to in the first
73 paragraph of the order of this Commission, to the extent that said System of Accounts has any application thereto, its provisions have been complied with, appropriate amounts have

been entered in Account 100.4 and the entries to operating expense accounts for the purpose of amortizing amounts so included in Account 100.4 have been made in accordance with a plan approved by the Commission.

5. No other entries, and specifically no entry to Account 413 Miscellaneous Debits to Surplus in the amount of $4,166,510.57, are required or appropriate under the Commission's system of accounts and binding administrative constructions with respect thereto.

Wherefore respondent respectfully prays that the order herein dated June 16, 1942, be vacated and set aside and that the proceeding commenced thereby be dismissed.

NEW YORK TELEPHONE COMPANY,
By (Sgd.) FRANK A. FRITZ,
*Assistant General Attorney,*
*140 West Street, New York, N. Y.*

Dated: New York, N. Y., July 3, 1942.

74 [*Duly sworn to by Benjamin F. Young; jurat omitted in printing.*]

75 *Exhibit F to complaint*

Before the Federal Communications Commission

Docket No. 6329—P-30

IN THE MATTER OF NEW YORK TELEPHONE COMPANY, ACCOUNTING

PETITION FOR MODIFICATION OF ORDER DATED DECEMBER 14, 1943

Now comes New York Telephone Company, the respondent herein, and respectfully prays that the Commission modify its order herein dated December 14, 1943 (hereinafter referred to as "the Order"), in the respects and for the reasons hereinafter set forth:

1. Respondent intends to institute a proceeding in the District Court of the United States for the Southern District of New York, pursuant to Section 402 (a) of the Communications Act of 1934 and the Act of October 22, 1913, Ch. 32, 38 Stat. 219, 220, to enjoin, set aside, annul and suspend the Order, on the ground that the Order exceeds the powers conferred by the Communications Act of 1934, and for this and other reasons is illegal and void. Respondent intends to institute such proceedings promptly and in any event before the expiration of the 60-day period set forth in the fourth ordering paragraph of the Order.

2. Subparagraphs (1) and (2) of the second ordering paragraph of the Order require respondent to make entries affecting Accounts 413, 100.1, 100.4, 231, 171, and 172. Subparagraph (3) of the second

ordering paragraph of the Order requires respondent to make entries affecting Accounts 100.1, 100.4, 171, 172, and 413, as of December 31, 1941. Subparagraph (4) of the second ordering paragraph of the Order requires respondent to make
76
any necessary entries to adjust entries reflecting transactions subsequent to December 31, 1941, and to adjust between Accounts 231 and 122 as may be required to be consistent with the other entries required by the Order. The making of the entries required by the Order would also affect respondent's current charges for depreciation and retirement so far as concerns the instruments acquired from American Telephone & Telegraph Company which are recorded in Account 231.

3. Respondent is under the necessity of making a large number of financial reports to this Commission, to the Public Service Commissions of New York and Connecticut, to various tax authorities, Federal and state, to the Securities and Exchange Commission, to the New York Stock Exchange, to the holders of its Series C 3% Bonds, and to investors generally. Certain of these reports are issued monthly, certain of them are issued quarterly and certain of them are issued annually.

4. Respondent considers that it would be seriously detrimental to its interests to be required, while proceedings for the review of the Order are pending, to show in the said reports the reduction in surplus and the increase in its already adequate depreciation reserve which are prescribed by the Order and which respondent does not regard as consistent with the facts. Respondent further considers that it would be seriously detrimental to its interests to be required, prior to ultimate determination as to the validity of the Order, to make the entries set forth in paragraph 2 of this petition, all of which entries will be reversed if the Order is determined to be invalid.

5. Respondent therefore requests that the Commission modify the fourth ordering paragraph of the Order so as to extend the time within which respondent is required to submit verified proof of the making of the journal entries required by subparagraphs (1), (2), (3), and (4) of the second ordering paragraph of the Order, to a date 30 days from the final determination of a proceeding to be instituted by the respondent to enjoin, set aside,
77
annul and suspend the Order as set forth in paragraph 1 hereof. In the event of such modification of the Order, respondent would propose to charge to its Account 415, "Miscellaneous Reservations of Surplus," and concurrently credit to its Account 180, "Surplus Reserved," the amount of $4,166,510.57, referred to in the Order, with appropriate notation, and to retain

the said sum in Account 180 pending the final determination of the proceeding referred to in paragraph 1 of this petition, at which time appropriate entries in accordance with such final determination would be made.

6. The modification of the Order proposed in paragraph 5 of this petition would reserve the amount of surplus necessary to enable respondent to comply with the Order if the Order is upheld and would avoid the needless injury and damage to the respondent that would otherwise ensue.

Wherefore, respondent respectfully prays that the Commission enter an order herein modifying the fourth ordering paragraph of the Order so as to extend the time within which respondent is required to submit verified proof of the making of the journal entries required by subparagraphs (1), (2), (3), and (4) of the second ordering paragraph of the Order, to a date 30 days from the final determination of a proceeding to be promptly instituted by the respondent to enjoin, set aside, annul and suspend the Order, upon condition that respondent submit verified proof within 10 days from the making of such amendatory order that it has made entries in its Accounts 415 and 180, as set forth in paragraph 5 of this petition, and that respondent retain in Account 180 the amount transferred by such entries pending the final determination of such proceeding; and for such other, further and different relief as may be just and equitable.

New York Telephone Company,
By Ralph W. Brown,
*Vice-President and General Counsel,*
*Attorney for Respondent.*

Dated, New York City, January 15, 1944.

78 *Exhibit G to complaint*

Before the Federal Communications Commission, Washington 25, D. C.

Docket No. 6329—P-30

In the Matter of New York Telephone Company, Accounting

Order

At a session of the Federal Communications Commission held at its office in Washington, D. C., on the 25th day of January 1944:

The Commission, having under consideration its Report and Order of December 14, 1943 herein (P-30), and having also under

consideration a petition filed on January 17, 1944 by the New York Telephone Company for modification of the above Order of the Commission, so as to extend the time for compliance with the Order pending determination of a court proceeding to be promptly instituted by the Telephone Company to enjoin the Order, upon condition that the Company retain the amount of $4,166,510.57 in its account 180, "Surplus reserved," pending the final determination of the court proceeding;

It is ordered, That to the extent that the Commission's Order of December 14, 1943 herein requires that the New York Telephone Company shall submit within 60 days from the service of that Order, verified proof that the journal entries required there-
79 in have been made, such Order is hereby modified to the effect that such verified proof shall be filed at a later date to be specified by subsequent Order of the Commission, having regard to the course of the court proceeding which the New York Telephone Company intends promptly to institute with respect to such Order of the Commission; provided, however, that the New York Telephone Company shall comply with the following conditions: The New York Telephone Company shall charge to its account 415, "Miscellaneous reservations of surplus," and concurrently credit to its account 180, "Surplus reserved," the amount of $4,166,510.57, with appropriate notations in all published balance sheets; the New York Telephone Company shall submit verified proof within ten days from the date of this Order that such entries in its accounts 415 and 180 have been made; and the New York Telephone Company shall, until further order of the Commission, retain in its account 180 the amount of $4,166,510.57 transferred to that account by such entries.

By the Commission.

(SGD.) T. J. SLOWIE,
T. J. Slowie, *Secretary*.

80 In United States District Court

[Title omitted.]

*Order convening three-judge court*

The plaintiff herein having filed a petition verified the 9th day of February, 1944 in which it prays that this Court enter a judgment permanently enjoining, setting aside, annulling, and suspending a certain order of the Federal Communications Commission, in the proceeding which is said Commission's Docket

No. 6329, and said proceeding having been brought under the provisions of the Urgent Deficiencies Appropriations Act (38 Stat. 219, 220; 28 U. S. C. §§ 41 (28), 43–48 inclusive) which sections provide for the appointment of a special Court, consisting of three Judges, of whom at least one shall be a Circuit Judge, in all actions to set aside and annul orders of the Interstate Commerce Commission, and under the provisions of the Communications Act of 1934 (48 Stat. 1064, 1093; 47 U. S. C. § 402 (a)) which provides that the provisions relating to the enforcing or setting aside of the orders of the Interstate Commerce Commission are made applicable to suits to enforce, enjoin, set aside, annul, or suspend any order of the Federal Communications Commission, with certain exceptions not here applicable.

The undersigned hereby calls the Honorable Thomas W. Swan, United States Circuit Judge for the Second Circuit, and the Honorable John W. Clancy, United States District Judge for the Southern District of New York, to the assistance of the undersigned, to hear the said suit and any proceedings in connection therewith.

Dated New York, N. Y., March 17, 1944.

JOHN BRIGHT, *U. S. D. J.*

82 In United States District Court

[Title omitted.]

*Notice of motion for summary judgment*

SIR: Please take notice that on the complaint herein, together with the exhibits thereto annexed and on the annexed affidavit of Charles R. Denny, sworn to the 17th day of March 1944, together with the certified record of proceedings had in Federal Communications Commission Docket No. 6329 and upon all the other papers and proceedings heretofore filed and had herein, the undersigned will move the Honorable Thomas W. Swan, the Honorable John Bright, and the Honorable John W. Clancy, constituting a special court appointed pursuant to a certain order dated March 17, 1944, on the 1st day of June 1944, in Room 506 of the United States Court House, Foley Square, Borough of Manhattan, City and State of New York, at 2:30 o'clock in the afternoon of said day, or at such time and place as the aforesaid court may designate, for an order directing that summary judgment be entered in favor of the defendants on the ground that the complaint and exhibits annexed thereto, the annexed affidavit and the record of proceedings in said

Commission's Docket No. 6329 show that there is no genuine issue as to any material fact and that the defendants are entitled to a judgment as a matter of law.

Dated New York, N. Y. March 28, 1944.

Yours, etc.

JAMES B. MCNALLY,

*United States Attorney for the Southern District of New York, Attorney for United States of America. Office & P. O. Address: United States Court House, Foley Square, Borough of Manhattan, City of New York.*

CHARLES R. DENNY,

*General Counsel, Federal Communications Commission, Attorney for Federal Communications Commission. Office & P. O. Address: New Post Office Bldg., Washington, D. C.*

To: HENRY J. FRIENDLY, Esq.

*31 Nassau Street, Borough of Manhattan, City of New York. Attorney for Petitioner.*

83 In United States District Court

[Title omitted.]

*Affidavit of Charles R. Denny*

DISTRICT OF COLUMBIA, *ss:*

Charles R. Denny, being duly sworn, says:

1. He is General Counsel of the Federal Communications Commission, and as such is familiar with the Commission's proceedings in Docket 6329, and that the proceedings include the following:

(a) On June 16, 1942, the Commission issued an order reciting that on November 1, 1925, September 1, 1926, and December 31, 1928, New York Telephone Company, acquired certain telephone property from its parent, American Telephone and Telegraph Company, for which it paid an amount $1,659,551.91 in excess of the book cost, as retired, less the related depreciation and amortization reserves as reflected on the books of American Telephone and Telegraph Company; and that on December 31, 1927, New York Telephone Company acquired certain telephone instruments from American Telephone and Telegraph Company for which it paid an amount $2,506,958.66 in excess of the book cost less the related depreciation reserve as reflected on the books of American Telephone and Telegraph Company. The order further recited that as a result of the ac-

counting performed by New York Telephone Company at the time of and since the respective dates of the above acquisitions, an insufficient amount is included in its Account 100.4, "Telephone plant acquisition adjustment"; and that since the effective date, January 1, 1937, of the Commission's Uniform System of Accounts for Class A and Class B Telephone Companies, New York Telephone Company has made, and is continuing to make, charges to operating expense accounts for the purpose of amortizing or otherwise disposing of amounts included in its Account 100.4, without prior direction, authorization, or approval by the Commission.

(b) The order of June 16, 1942, directed that a general investigation be instituted into the accounting performed and the accounts, records, and memoranda kept by New York Telephone Company at the time of and during the period since all of its several acquisitions of telephone property, with respect to and as a result of such acquisitions. New York Telephone Company was made a respondent and it was required to show cause why the amount of $4,166,510.57 should not be charged to respondent's Account 413, "Miscellaneous debits to surplus," with concurrent entries to such accounts as may be appropriate in the light of the accounting performed at the time of and since the respective dates of the four acquisitions with which such amount was associated.

(c) The order of June 16, 1942, also suspended all charges to operating expense accounts made by New York on and after January 1, 1942, for the purpose of, or in conjunction with, amortizing or otherwise disposing of amounts included in its Account 100.4 "Telephone plant acquisition adjustment,"
84 pending submission of proof by respondent of the propriety and reasonableness of such charges; and ordered respondent to cease and desist from making any such charges pending submission of such proof.

(d) A hearing was ordered for July 30, 1942, and it was provided that the hearing should be conducted jointly with any hearings involving similar matters which might be ordered for the same time and place by the Public Service Commission of New York and the Connecticut Public Utilities Commisison. It was also ordered that the order should be served upon respondent and each of its officers and directors, the Public Service Commission of New York, the Connecticut Public Utilities Commission, the Massachusetts Department of Public Utilities, the Vermont Public Service Commission, the Pennsylvania Public Utility Commission, the New Jersey Board of Public Utility Commissioners, and the National Association of Railroad and Utilities Commissioners.

(e) On January 25, 1938, the New York State Public Service Commission had instituted its Case No. 9436 by an order of investigation into the books, records, and accounts of New York Telephone Company and as to its entries reflecting the acquisition of property acquired from other telephone companies. Hearings before that Commission had been held in February 1938, and October 1939, and the matter was set down for further hearing at the same time and place as the hearing ordered by the Federal Communications Commission in Docket 6329.

(f) Joint hearings were held before Commissioners Walker and Wakefield of the Federal Communications Commission, and Commissioners Maltbie and Van Nasee of the New York Public Service Commission. Hearings were begun on July 30, 1942. Further hearings were held on July 31, September 16, 17, 18, 30, October 14, 15, 16, 28, 29, 30, November 25, December 10 and 11, 1942. New York Telephone Company participated and presented evidence in these hearings. Evidence was also submitted by members of the staff of both Commissions and witnesses called on behalf of both Commissions.

(g) On January 19, 1943, New York Telephone Company filed its Proposed Findings of Fact and Conclusions, and a supporting brief.

(h) On June 22, 1943, the Commission issued its Proposed Report in which it concluded that the amount of $4,166,510.57 should be charged to Account 413, "Miscellaneous debits to surplus," with concurrent entries to appropriate accounts, specified in the Proposed Report.

(i) On July 16, 1943, New York Telephone Company filed exceptions to the Commission's Proposed Report, together with a supporting brief, and requested oral argument before the Commission. Oral argument was held before the Commission en banc on September 22, 1943.

(j) On December 14, 1943, the Commission issued its final Report and Order. The Commission directed that:

(1) The New York Telephone Company shall charge (debit) the amount of $4,166,510.57 to its Account 413, "Miscellaneous Debits to Surplus";

85 (2) The New York Telephone Company shall, concurrently with such charge to Account 413, make entries (a) to eliminate, by appropriate entries to its Account 100.4, "Telephone Plant Acquisition Adjustment," the amounts presently included in that account, associated with the New York Telephone Company's acquisition from the American Telephone and Telegraph Company on November 1, 1925, September 1, 1926, and December 31, 1928; (b) to eliminate the Amounts presently in-

cluded in Account 172, "Amortization Reserve," associated with such acquisitions, with contra entries to Account 171, "Depreciation Reserve"; (c) to adjust the balances in Account 100.1, "Telephone Plant in Service," and the related primary plant Account 231, "Station Apparatus," to reflect the original cost of the surviving telephone instruments acquired by the New York Telephone Company from the American Telephone and Telegraph Company on December 31, 1927, by debits to those accounts in the amount of the difference between such original cost and the surviving amounts recorded in such accounts; and (d) to adjust the balance in Account 171, to reflect appropriately the elimination of the intercompany profit or write-up of $4,166,510.57 resulting from the accounting performed by the New York Telephone Company at the time of and during the period since such acquisition, with respect to and as a result of such acquisitions, by credits to that account equal to the difference between the amounts debited to Account 100.1 and Account 413, and the amounts credited to Account 100.4;

(3) The New York Telephone Company shall correct its books and records as of December 31, 1941, by placing thereon the following entries:

*Entry No. 1*

| | | Debit | Credit |
|---|---|---|---|
| 100.1 | Telephone plant in service (account 231, station apparatus) | $194,886.97 | |
| 100.4 | Telephone plant acquisition adjustment | | $481,439.60 |
| 171 | Depreciation reserve | | 3,879,957.94 |
| 413 | Miscellaneous debits to surplus | 4,166,510.57 | |

This entry made in accordance with the order of the Federal Communications Commission dated December 14, 1943, in Docket No. 6329.

*Entry No. 2*

| | | Debit | Credit |
|---|---|---|---|
| 171 | Depreciation reserve | | $333,559.21 |
| 172 | Amortization reserve | $333,559.21 | |

This entry made in accordance with the order of the Federal Communications Commission dated December 14, 1943, in Docket No. 6329.

(4) The New York Telephone Company shall make any necessary entries to adjust entries reflecting transactions subsequent to December 31, 1941, and to adjust between Account 231, "Station apparatus," and Account 122, "Material and Supplies," as may be required to be consistent with the entries required by the above provisions of this order.

86 (5) All charges which the New York Telephone Company has made to its operating expense accounts for the purpose of, or in conjunction with, amortizing or otherwise disposing of; all amounts included in its Account 100.4 other than those included therein with respect to the toll property acquisitions dated November 1, 1925, September 1, 1926, and December 31, 1928, shall continue to be suspended, and respondent shall cease and desist from making any such charges to its operating expense accounts, pending submission of proof by respondent of the propriety and reasonableness of such charges, and the specific direction, authorization, or approval of the Commission.

(k) The Order further provided that the New York Telephone Company should within 60 days submit verified proof that the journal entries required by the Order had been made, and that it should within 40 days notify the Commission in writing whether the order and all of its terms and requirements are accepted and will be obeyed.

(l) On December 14, 1943, the New York Public Service Commission also issued its Report and Order in its Case No. 9436. This Order is substantially the same as that of the Federal Communications Commission.

(m) On January 17, 1944, New York Telephone Company filed a Petition for Modification of Order, requesting an extension of time for compliance with the Commission's Order of December 14, 1943, until 30 days after final determination of a court proceeding to be instituted by New York Telephone Company to set aside, enjoin, annul, and suspend the order;

(n) On January 25, 1944, the Commission issued an order providing in part as follows:

"That to the extent that the Commission's Order of December 14, 1943, herein requires that the New York Telephone Company shall submit within 60 days from the service of that Order, verified proof that the journal entries required therein have been made, such Order is hereby modified to the effect that such verified proof shall be filed at a later date to be specified by subsequent Order of the Commission, having regard to the course of the court proceeding which the New York Telephone Company intends promptly to institute with respect to such Order of the Commission; provided, however, that the New York Telephone Company shall comply with the following conditions: The New York Telephone Company shall charge to its account 415, 'Miscellaneous reservations of surplus,' and concurrently credit to its account 180, 'Surplus reserved,' the amount of $4,166,510.57, with appropriate notations in all published balance sheets; the New York Telephone Company shall submit verified proof within ten days from the

date of this Order that such entries in its accounts 415 and 180 have been made; and the New York Telephone Company shall, until further order of the Commission retain in its account 180 the amount of $4,166,510.57 transferred to that account by such entries."

2. A certified copy of said proceedings before the Commission in Docket No. 6329 is filed herewith and incorporated herein by reference as Exhibit A.

3. The grounds urged by plaintiff in support of its contention that the order of the Commission is not supported by substantial evidence, is entirely at odds with fundamental principles of correct accounting, is beyond the statutory power and authority of the Commission, and is illegal and void, are as follows:

87 (a) The Order requires the correction of an alleged error in plaintiff's accounting, although no error was made and such accounting was in accordance with the requirements of the Uniform System of Accounts for Telephone Companies prescribed by the Interstate Commerce Commission, to which plaintiff was subject at the date when the transaction occurred;

(b) The Order requires accounting for property purchased from an affiliated company, at a date prior to the effective date of the Federal Communications Commission's Uniform System of Accounts for Telephone Companies, in a bona fide transaction and at a fair price, which is wholly different from the accounting for property purchased from a company not so affiliated, although no provision of the Uniform System of Accounts for Telephone Companies prescribed by the Interstate Commerce Commission which was in effect at the time of the transactions here in question, or of the later revision of said System, or of the Uniform System of Accounts for Telephone Companies prescribed by the Federal Communications Commission, makes any distinction between purchases from an affiliated company and purchases from a company not so affiliated;

(c) The Order prevents the plaintiff from showing in its accounts the facts as to the purchases of property made by it from the American Company as set forth in this complaint, and requires the plaintiff to account for the said purchase on a basis which will not reflect either the plaintiff's actual investment in the property acquired or the value thereof;

(d) The Order compels the plaintiff to rewrite its accounts as if a rule of substantive law required that a purchase of property from an affiliated telephone company must be at the net book cost of the selling company or that a purchase on any other basis must be disregarded as "fictitious," although no such rule of sub-

stantive law existed at the time of the transactions here in question, or now exits, and although the Commission has not been vested with power to establish any such rule of substantive law either prospectively or retroactively;

(e) The Order prescribes a rule of accounting to be made retroactively effective with respect to transactions executed prior to the effective date of the Commission's Uniform System of Accounts and of the Communications Act of 1934;

(f) The Order prescribes a rule of accounting to be made retroactively effective to a date when plaintiff's accounts were prescribed by the Interstate Commerce Commission, as the duly authorized agency of the Government, and the rule now sought to be made retroactively effective by the Commission is at variance with the accounting so prescribed by the Interstate Commerce Commission;

(g) The Order does not direct a reclassification of the balances existing in plaintiff's accounts as of January 1, 1937, the effective date of the Commission's Uniform System of Accounts for Telephone Companies, but requires that certain of said balances be written off to plaintiff's surplus account and that
88 a further write-off be made to plaintiff's surplus account in respect of property which had been removed from plaintiff's plant accounts and charged to its adequate depreciation reserve prior to the effective date of said Uniform System of Accounts;

(h) The Order requires accounting which is contrary to the Commission's Uniform System of Accounts for Telephone Companies as construed by this Court and in "the administrative construction binding upon the Commission in its future dealings with the companies" filed by these defendants in the Supreme Court of the United States, in the suit initiated in this Court entitled, "American Telephone and Telegraph Company, et al., plaintiffs, against United States of America and Federal Communications Commisison, defendants, In Equity No. 81–366," to which suit this plaintiff and these defendants were adverse parties;

(i) The Order requires plaintiff to increase its depreciation reserve, although the undisputed evidence showed that plaintiff's depreciation reserve was adequate;

(j) The Commission denied the plaintiff a fair hearing, particularly by depriving plaintiff of the opportunity to demonstrate fully that the amount paid by the plaintiff for the toll plant and instruments acquired by the plaintiff from the American Company did not exceed the value of the property so acquired; and

(k) For the reasons above set forth the Order deprives the plaintiff of its liberty and property without due process of law in

violation of the Fifth Amendment of the Constitution of the United States.

4. Affiant submits that Exhibit A is relevant on the above issues sought to be raised and that it shows that the order is within the Commission's authority conferred by the Communications Act; that it does not deprive plaintiff of its liberty and property without due process of law; that it is not arbitrary and capricious or contrary to law, but is proper and reasonable and is supported by substantial evidence; and that there is no genuine issue as to any material fact.

(Signed) Charles R. Denny.
CHARLES R. DENNY.

Subscribed to and sworn to before me this 17th day of March 1944.

HELEN A. MARSTON,
*Notary Public.*

89 Before the Federal Communications Commission, Washington 25, D. C.

Docket No. 6329—P-30

IN THE MATTER OF NEW YORK TELEPHONE COMPANY, ACCOUNTING

Appearances: Edward L. Blackman, Esq., Ralph W. Brown, Esq., John H. Machan, Esq., and Frank A. Fritz, Esq., on behalf of New York Telephone Company; Harry Hertzoff, Esq., on behalf of the City of New York; R. J. McVeigh, Esq., and John T. Ryan, Esq., on behalf of the Public Service Commission of the State of New York; and Daryal A. Myse, Esq., on behalf of the Federal Communications Commission.

PROPOSED REPORT OF THE COMMISSION

1. This proceeding was initiated by order of the Commission on June 16, 1942. The Order instituted a general investigation into the accounting performed and the accounts, records, and memoranda kept by New York Telephone Company (hereinafter sometimes referred to as "New York"), at the time of and during the period since all of its several acquisitions of telephone property, with respect to and as a result of such acquisitions. The Order made New York respondent and required it to show cause why $4,166,510.57 should not be charged to respondent's Account 413, "Miscellaneous debits to surplus," with concurrent entries to such accounts as may be appropriate in the light of the accounting performed at the time of and since the respective

dates of the four acquisitions with which such amount was associated. The $4,166,510.57 was stated in the Order to represent amounts paid to American Telephone and Telegraph Company (hereinafter sometimes referred to as "A. T. & T.") by New York for telephone property acquired from A. T. & T. on November 1, 1925, September 1, 1926, December 31, 1927, and December 31, 1928, in excess of the book cost less the related depreciation and amortization reserves, as reflected on the books of A. T. & T. and its Long Lines Department.[1]

90 2. The Order of June 16, 1942, also suspended all charges to operating expense accounts made by New York on and after January 1, 1942, for the purpose of, or in conjunction with, amortizing or otherwise disposing of amounts included in its Account 100.4 "Telephone plant acquisition adjustment," pending submission of proof by respondent of the propriety and reasonableness of such charges; and ordered respondent to cease and desist from making any such charges pending submission of such proof. The Order further recited that as a result of the accounting performed by New York, at the time of and since the respective dates of the several acquisitions of telephone property specifically mentioned above, an insufficient amount is included in respondent's Account 100.4; and that since January 1, 1937, the effective date of the Commission's Uniform System of Accounts for Class A and Class B Telephone Companies, New York made charges to operating expense accounts for the purpose of amortizing or otherwise disposing of amounts included in its Account 100.4 without prior direction, authorization, or approval by the Commission. An investigation was also ordered instituted to determine whether respondent or any of its officers and directors have violated the provisions of Account 100.4 (c),[2] Account 614,[3] Commission Order No. 60[4] or Section 220 (g) of the Communications Act of 1934. Respondent and each of its officers and directors were required to file verified answers. Appropriate notice was given to the State Commissions having jurisdiction with respect to New York and to the National Association of Railroad and Utilities Commissioners. Although a hearing is not a prerequisite to action by the Commission under Section 220 of the Act, a hearing was ordered, with provision for its conduct jointly with hearings involving similar matters before the New York and Connecticut State Commissions. Under Section 220 of the Act respondent has the statutory burden of justifying the ac-

[1] The Long Lines Department of A. T. & T. operates a nation-wide system of interstate toll line circuits. A separate set of accounts is kept to reflect the separate operations of the Long Lines Department.

[2] Section 31.100 : 4 of the Commission's Rules and Regulations.

[3] Section 31.614 of the Commission's Rules and Regulations.

[4] Adopted July 12, 1939.

counting entries questioned by the Commission. (Cf. Re Additional Charges to Operating Expense Account 672 (Relief and Pensions), F. C. C. Docket No. 5188, decided December 2, 1942.)

3. On January 25, 1938, the New York State Public Service Commission had instituted its Case No. 9436 by an order of investigation into the books, records, and accounts of New York and as to its entries reflecting the acquisition of property acquired from other telephone companies. Hearings before that Commission had been held in February 1938, and October 1939, and the matter was set down for further hearing at the same time and place as the hearing ordered by this Commission in this proceeding. Joint hearings in both proceedings were held before Commissioners Walker and Wakefield, of this Commission, and Commissioners Maltbie and Van Namee of the New York State Public Service Commission, beginning July 30, 1942, and con-
91 tinuing intermittently to December 11, 1942. Proposed Findings of Fact and Conclusions and a Brief have been filed by New York.

4. Among the 22 or more acquisitions of telephone property prior to January 1, 1937, reported by New York and involved in this proceeding, only four are involved in the show cause provisions of the Commission's Order of June 16, 1942. These four were property acquisitions from A. T. & T. and the amounts of money involved are a major portion of the total amount involved in all of New York's telephone property acquisitions from predecessor telephone companies. A. T. & T. has at all times material to this proceeding controlled New York through its ownership of 100% of New York's Common stock. On November 1, 1925, September 1, 1926, and December 31, 1928, New York acquired portions of certain toll line property in the State of New York from the Long Lines Department of A. T. & T. and paid $5,973,441.47 therefor. Much of the acquired property was in the form of an additional interest in toll lines owned jointly by New York and A. T. & T. Portions of such acquired property had been originally constructed by New York and transferred to A. T. & T. at amounts equivalent to cost of construction. Those portions of the jointly owned property constructed by New York, and as to which ownership was retained by New York, are recorded on New York's books at the original cost to it. In accounting for the transactions the property acquired by New York was retired on the books of the Long Lines Department, at what A. T. & T. considered to be its book cost to A. T. & T. in the amount of $5,134,342.49; and an amount of $820,453.93 was charged (debited) to the depreciation and amortization reserve accounts of the Long Lines Department as the estimated alloca-

tion of the book reserves of the Long Lines Department related to that property. The amount paid by New York to A. T. & T. was, therefore, $1,659,551.91 in excess of the book cost less the related depreciation and amortization reserves, as reflected on the books of A. T. & T. On December 31, 1927, New York acquired certain telephone instruments from A. T. & T. The instruments acquired consisted of all of the principal operating parts of the telephone subscriber stations (receivers, transmitters and induction coils) in use at the time by New York. The amount paid by New York to A. T. & T. was $6,661,238.91. In accounting for this transaction A. T. & T. retired the instruments on its books at what it considered to be book cost to it, in an amount of $8,135,224.98; and an amount of $3,980,944.73 was charged (debited) to its depreciation reserve account for telephone instruments as the estimated allocation of such reserve related to those instruments. The amount paid by New York to A. T. & T. was, therefore, $2,506,958.66 in excess of the book cost less the related depreciation reserve, as reflected on the books of A. T. & T. The total of the two amounts of $1,659,551.91 and $2,506,958.66 equals $4,166,510.57 and this total amount was credited to A. T. & T.'s surplus accounts.[5] The Commis-
92 sion's Order of June 16, 1942, required New York to show cause why such amount should not be charged (debited) to New York's surplus account.

5. At the time of the respective acquisitions from A. T. & T., referred to above, New York recorded in its plant account as cost of telephone plant purchased the amounts paid to A. T. & T. No entries were made in New York's depreciation or amortization reserve accounts in connection with such acquisitions. Nor were special depreciation rates thereafter applied to the amounts recorded in New York's plant accounts with respect to such acquired property, but the current depreciation rates applicable to the respective classes of plant were applied to such amounts as long as such property remained in service. From time to time, as portions of such acquired property were retired from service, estimated amounts, based upon compiled averaging of retirement unit costs, were retired on New York's books by crediting such amounts to the plant accounts and debiting an equivalent amount to its depreciation and amortization reserves.

6. On January 1, 1937, the Commission's Uniform System of Accounts for Class A and Class B Telephone Companies became

[5] The amount associated with the instrument transaction was credited to a special contingency surplus reserve account by A. T. & T.

effective[6] and its provisions are applicable to New York as a Class A Telephone Company. New York was thus required to reclassify the amounts recorded in its then existing accounts to conform with the provisions of such Uniform System of Accounts.[7] Under "Balance Sheet Accounts—Investments" the System provides that Account 100.1, "Telephone plant in service,"[8] shall include "the original cost of the company's property used in telephone service at the date of the balance sheet as classified under Accounts 201 to 277, inclusive"; and that Accounts 100.2 and 100.3[9] shall include the original cost of telephone plant under construction and property held for future telephone
93 use, respectively. The system further provides that Account 100.4,[10] "Telephone plant acquisition adjustment," shall include amounts "representing the difference between (1) the amount of money actually paid (or the current money value of any consideration other than money exchanged) for telephone plant acquired, plus preliminary expenses incurred in connection with the acquisition; and (2) the original cost of such plant, governmental franchises and similar rights acquired, less the amounts of reserve requirements for depreciation and amortization of the properties acquired." "Original cost" as used in Accounts 100.1 to 100.4, inclusive, is defined in the System of Accounts by Section 31.01-3 (x) of the Rules and Regulations as "the actual money cost of (or current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to the public use whether by the accounting company or by predecessors."[11]

7. In reclassifying its accounts as of January 1, 1937, New York first estimated the amounts attributable to the surviving toll line plant transferred to it in the 1925, 1926, and 1928 acquisitions from A. T. & T., which amounts had been originally included in its books on a so-called "structural value" basis. It then determined the difference between such amounts and what it assumed to be

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[6] Part 31 of the Commission's Rules and Regulations. On June 19, 1935, the Telephone Division of the Commission (See 1 F. C. C. 3 and Order No. 20, 4 F. C. C. 41) adopted its Order No. 7-C which prescribed a Uniform System of Accounts for Telephone Companies having average annual operating revenues exceeding $50,000, effective January 1, 1936 (1 F. C. C. 45). The operation of Order No. 7-C was stayed pending final decision by the United States District Court for the Southern District of New York, in the case of American Telephone and Telegraph Company et al. v. The United States, in Equity No. 81-366. After the decree of the District Court was affirmed by the Supreme Court of the United States on December 7, 1936 (American Telephone and Telegraph Co. et al. v. United States, 299 U. S. 232), the Telephone Division adopted its Order No. 7-D amending its Order No. 7-C in certain respects and making the amended System of Accounts effective January 1, 1937 (3 F. C. C. 9).

[7] Section 31.91-2 (e) of the Commission's Rules and Regulations.

[8] Section 31.100 : 1 of the Commission's Rules and Regulations.

[9] Section 31.100 : 2 and 31.100 : 3 of the Commission's Rules and Regulations.

[10] Section 31.100 : 4 of the Commission's Rules and Regulations.

[11] See Section 213 (c) of the Communications Act of 1934.

the original cost of such surviving plant, as originally reflected on the books of the A. T. & T.,[12] and placed the amount of such difference in its Account 100.4. The net amount consisting of both debits and credits so reclassified in Account 100.4, with respect to such acquisitions, was $483,975.83. An attempt was made to determine the amounts of the requirements for depreciation and amortization of such surviving plant, necessary in addition to the future accruals over the estimated remaining life at the current depreciation rates of the respective plant classes, and an amount of $271,280.98 was transferred in 1937 from New York's Account 171, "Depreciation reserve,"[13] to its Account 172, "Amortization reserve."[14]

94 Neither this amount nor any other amount was subtracted from the assumed original cost of such surviving plant as the reserve requirements for depreciation and amortization of such plant in determining the amount included in Account 100.4. No amounts were credited to Account 171 in the process of reclassification. At no time has New York reclassified on an original cost basis the amounts in its accounts associated with its acquisition of the telephone instruments from A. T. & T. in 1927. No amounts were or are included in Account 100.4 as a result of that transaction. As of January 1, 1942, it was estimated by New York that approximately 9½ to 15% of the instruments acquired by New York in 1927 remained in service.

8. In 1938 New York began amortizing the amounts included in its Account 100.4 by charges and credits to its operating expense Account 614, "Amortization of telephone plant acquisition adjustment," with concurrent entries to its Account 172. From time to time, when portions of the acquired plant were retired, amounts in Account 100.4 were written out of that account with a concurrent entry to Account 172. These amortization charges to Account 614 from January 1, 1942, were the charges which were suspended, and which New York was ordered to cease and desist from making, by the Commission's Order of June 16, 1942, herein.

9. The accounting which has been performed by New York with respect to the acquisitions here in question was improper. As has been found, the amounts paid by New York to A. T. & T., its parent company, for the transferred property were recorded by New York in its plant accounts at amounts in excess of the book cost,

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[12] The "original cost" so assumed reflected the amounts at which the property was retired by A. T. & T. and did not necessarily reflect the actual original cost of the property at the time it was first dedicated to the public use. In addition, much of the physical property was originally acquired from the Western Electric Company, Inc., a wholly owned subsidiary of A. T. & T. To the extent that Western may have made a profit by the furnishing of such property the "original cost" so used include an intercompany profit which should ultimately be eliminated.

[13] Section 31.171 of the Commission's Rules and Regulations.

[14] Section 31.172 of the Commission's Rules and Regulations.

less related depreciation and amortization reserves (net book cost), shown on the books of A. T. & T. These excess amounts represented a "profit" to A. T. & T. Since New York was, as it is now, a wholly-owned subsidiary of A. T. & T., and therefore fully subject to control by A. T. & T., the intercompany profits to A. T. & T. resulting from the affiliated company transfers of property involved here are fictitious or paper increments, and are as unreal as profits from interdepartmental transactions. The accounting performed by New York with respect to these property transfers resulted in a write-up of its accounts by the amount of such intercompany profits, and, therefore, in the inclusion of purely inflationary items in New York's accounts. The transfer of the property from the parent A. T. & T. to the subsidiary New York should not be permitted to convert the excess amounts over A. T. & T.'s net book investment from a fictitious intercompany profit to an investment in assets by New York. Upon consolidation of the affiliated company accounts, such intercompany profits should be eliminated. This was recognized by witnesses presented by New York, who were members of a firm of auditors regularly employed by A. T. & T. If the amounts of such fictitious profits are allowed to remain in New York's accounts they may become real profits to the affiliated group of companies by improper inclusion as a part of the cost of service. Since transfers of property were made in both directions between New York and A. T. & T. at prices in excess of the net book investment of each transferor
95 company, the combined surplus of the companies was increased, not as a result of any increase in income or property, not as a result of any change in the service rendered, but simply as a result of the accounting based upon fictitious sales and unnecessary transfers of unreal cash profits.[15] The passage of time can lend no sanction to improper accounting. Whenever errors in accounting are discovered, they should be corrected. The inflationary writeups found herein should, therefore, never have been recorded in New York's accounts, and should now be forthwith eliminated from New York's accounts.[16]

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[15] Nothing contained in this report should, however, be construed as approval of the amount of A. T. & T.'s net investment as recorded on its books.

[16] In view of this conclusion, it is unnecessary to consider the propriety of the accounting performed by New York on its assumption that Account 100.4 was to be used for the acquisitions here in question. We point out, however, that Account 100.4 and the method to be followed under the System of Accounts in reclassifying the accounts with respect to property acquisitions, as outlined by Section 31.2–21 of the accounting Rules and Regulations of this Commission, specifically require that the amounts includible in Account 100.4 shall reflect the difference between (1) the original cost, after deduction of the appropriate reserve requirements for depreciation and amortization, and (2) the amounts paid. No distinction is made in the accounting rules as between acquisitions prior to January 1, 1937, and those after that date. New York's failure to make any credit entries to Account 171 to reflect the reserve requirement for depreciation of acquired property, and to deduct the amount of such reserve requirement from original cost, in determining the amounts includible in its Account 100.4 results in the inclusion of insufficient amounts in that account.

10. Respondent contends that the amounts paid to its parent company, A. T. & T., as a result of the acquisitions of telephone property here under consideration were fair and reasonable and were not in excess of the fair and reasonable value of the property acquired; that after reclassifying its accounts, as of January 1, 1937, as outlined above, appropriate amounts were entered in its Account 100.4, and the entries to operating expense accounts for the purpose of amortizing amounts so included in Account 100.4 have been made in accordance with a plan approved by the Commission; and that therefore no other entries, and specifically no entry to its surplus Account 413, in the amount of $4,166,510.57, are required or appropriate under the Commission's Uniform System of Accounts. Respondent also asserts that the recording in its plant accounts of the full amounts paid to A. T.
96 & T. was in accordance with the accounting rules and practices prescribed by the Interstate Commerce Commission at the time of the respective property acquisitions; and that since the "structural value" of the property, as measured by reproduction cost new less actual depreciation, was equal to or more than such amounts so paid, the "prices" were fair and reasonable. Other contentions are advanced which are either subsidiary to those outlined above or are plainly irrelevant to a determination of the issues in this proceeding.[17] All of these contentions ignore the important fact that New York was and is a wholly owned subsidiary of A. T. & T. The fact of this ownership by A. T. & T., carrying with it the power to control New York, makes the fairness and reasonableness of the "prices" paid in such a transfer of property between such affiliated companies completely unrealistic. There was and could be no arms'-length bargaining between A. T. & T. and New York with respect to the amounts so paid. Any method of accounting which results in the inclusion in plant investment accounts of amounts based upon "values" agreed upon between a wholly owned subsidiary and its parent would nullify accounting from a regulatory standpoint. The full ultimate impact of such inflationary elements in the plant accounts is in time improperly reflected in the depreciation expense account as an alleged operating cost, unless, by proper regulatory requirements, the balance-sheet is cleared, or in the first instance is kept free, of such inflationary elements. Accounting, for purposes of efficient regulation of public utilities, must be firmly grounded on the cost principle, and if investment is to have some relationship to the investment dedicated to the public use by an affiliated group of companies, such agreed

[17] New York relies heavily on statements of the United States Supreme Court in American Telephone and Telegraph Co. v. U. E. et al., 299 U. S. 232, and the record in that case, with respect to the disposition of items included in Account 100.4. This position assumes that the items in question were properly recorded in Account 100.4. Such items should never have been recorded in that Account.

"values" must not be allowed to exist as a distortive element in their investment accounts. That the "value" of property transferred between affiliates can ever be represented by any amount greater than legitimate net book investment to the original affiliated owner is at best an illusion born of accounting aberrations existing during the period of the 1920's. Certainly such "values" cannot be represented by an estimate of such an inherently speculative nature as reproduction cost less depreciation.[18]

97 Respondent's assertions as to the method of accounting followed at the time of the property acquisitions here involved being in accordance with accounting rules and practices prescribed by the Interstate Commerce Commission and in effect at that time are not supported by the record. There is nothing in the Uniform System of Accounts for Telephone Companies, effective January 1, 1913, prescribed by the Interstate Commerce Commission and in effect during the period 1925 through 1928, requiring or authorizing the recording of property acquisitions from affiliates at any amount greater than the net book investment of the transferring affiliate. Instruction 13 of that system of accounts, relied upon by New York, was not intended to be applicable to tranfers of property between affiliates such as those involved here.[19] As we read the provisions of the Uniform System of Accounts for Telephone Corporations prescribed by the Public Service Commission, Second District, State of New York, effective January 1, 1912, as amended on March 17, 1921,[20] the

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[18] The highly speculative nature of estimates of reproduction cost less depreciation is illustrated by the following defects in respondent's showings and offers of proof in this respect: The reproduction cost new figures were based in part upon prices of the Western Electric Company, Inc., another wholly owned subsidiary of A. T. & T., without elimination of Western Electric profits. Such reproduction cost figures were based upon costs to A. T. & T. rather than the generally lower costs of New York. The amount deducted for depreciation was inadequate in that there was a failure to make adequate allowance for obsolescence and inadequacy. The character of this latter proof was such that it is entitled to little if any weight. The amount paid for the instruments was based upon Western Electric prices with an arbitrary deduction of 20% from the gross calculated price. The 20% was grossly inadequate when compared with the depreciation reserve of approximately 50% accrued by A. T. & T. as depreciation applicable to the instruments.

[19] As early as 1914, and in subsequent correspondence, the New England Telephone and Telegraph Company, an Associated Bell System company, and A. T. & T. requested rulings by the Interstate Commerce Commission as to whether Instruction 13 of the I. C. C. system of accounts applied to the accounting for transfers of property between affiliated companies of the Bell System, the companies contending that it did not. The Interstate Commerce Commission replies stated specifically that Instruction 13 was not intended to apply to the affiliated company transfers submitted to it. Mr. C. D. Crandall, present Director of the I. C. C. Bureau of Accounts, confirmed the position of the I. C. C. as stated in such early correspondence.

[20] The pertinent provisions of Section 7 of the General Instructions contained in the New York System of Accounts read as follows:

"7. Plant and equipment and other property purchased.—When any telephone line or part thereof (excepting new or used material and supplies) is purchased for a lump sum, an appraisal of the property so acquired shall be made, classifying the various constituent elements in the property according to the accounts prescribed by this Commission in its Uniform System of Accounts for Telephone Corporations. The actual money value of the consideration given for the plant or other property purchased shall be distributed to such accounts in accordance with the appraisal, but in no case shall the values assigned to tangible fixed capital accounts exceed the cost to reconstruct such plant and equipment at prices in effect at the time of purchase, *and when there is substantial identity of interest between the vendor and the vendee the values assigned to tangible fixed capital accounts shall not exceed the original cost of such property to the vendor. The estimated accrued depreciation on property purchased shall be set upon the books of the vendee as an offsetting liability to the cost of property so acquired.* * * *" [Italics supplied.]

accounting performed by New York with respect to the property acquisitions here involved was contrary to such provisions.

98 11. Respondent asserts that insofar as amounts in its accounts with respect to the property which was acquired from A. T. & T. have been retired from New York's books the amounts of write-ups or inflationary items have been removed from its accounts, and that therefore no charges to surplus are now necessary or appropriate to eliminate such amounts. But the credits to plant accounts and debts to reserve accounts made by New York to reflect the retirement of portions of the acquired property did not remove the inflationary items from its accounts. Those items are still included in its accounts, either in its Account 100.4, or as a deficiency in its depreciation reserve Account 171, or a combination of both. The deficiency in New York's depreciation reserve account results from the existence of debits made to and included in such reserve account, in recording the retirement of the acquired property, in amounts in excess of the original cost to A. T. & T. of such retired property less the related depreciation reserves. These debit amounts were included in New York's depreciation reserve account despite the fact that insufficient credits had been made to such reserve account for purposes of retirement of such property.[21]

12. New York's amortization of the debit amounts included in its Account 100.4 by charges to its operating expense accounts, and its amortization of the credit amounts included in that account by credits to its operating expense accounts, were begun in 1938 without any prior direction, authorization, or approval having been given to New York by this Commission. Such action was improper, even on the basis of New York's assumption that the amounts being so amortized were properly recorded in Account 100.4. Subsection (c) of Account 100.4 requires that the amounts included in that account be disposed of, written off, or amortized as directed by the Commission. Account 614, the operating expense account to which such amortization charges and credits were made by New York, permits such charges or credits only when authorized by the Commission.[22] On July 12, 1939,

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[21] In cases where telephone plant was retired, and sufficient depreciation had not been provided by credits to the depreciation reserve account, instruction 23 of the 1913 Interstate Commerce Commission System of Accounts required that the amount of deficiency be written off through charges to Account 413, "Realized Depreciation not Covered by Reserves," a Corporate Surplus or Deficit account. No such charges to Account 413 were made by respondent in connection with its retirement of any of the acquired property involved herein. This Commission's prescribed Account 413, "Miscellaneous debits to surplus," among other things, serves the same purpose as the I. C. C. system's Account 413 and Instruction 23.

[22] Account 614 reads as follows: "§ 31.614 Amortization of telephone plant acquisition adjustment.—This account shall be charged or credited, each month with such amounts as may be authorized by the Commission to be included in operating expenses under a plan to amortize amounts in Account 100.4, 'Telephone plant acquisition adjustment.' Amounts so entered shall be charged or credited, as appropriate, to Account 172, 'Amortization reserve.'"

99 the Commission adopted its Order No. 60 in which the Commission allowed all telephone companies to dispose of any debit amounts includible in Account 100.4 by charges to surplus, or by amortization over a reasonable period through charges to Account 323, "Miscellaneous income charges,"[23] without further direction or approval by the Commission. The order also directed companies desiring another manner of disposition of such debits amounts to request "that the Commission approve the recommended disposition or direct appropriate disposition according to the circumstances involved in each transaction." Disposition of credit amounts was ordered to be "as the Commission may approve or direct." Appropriate reservation was made to require subsequent disposition by charges to surplus or to alter the previously determined amortization periods.[24] No direction, authorization or approval has ever been given to New York by this Commission to dispose of amounts in Account 100.4 by amortization through charges or credits to Account 614, or any other operating expense account. As our findings herein show, no such direction, authorization, or approval would have been appropriate. We find that the amoritization through operating expenses of the amounts included in New York's Account 100.4, which amortization was begun by New York in 1938, was in violation of the Commission's Accounting Rules and Regulations, particularly Subsection (c) of Account 100.4, Account 614, and Order No. 60. Complete rectification of such amortization entries since 1938 by reversal thereof will not be required because Respondent's accounts for the years 1938 through 1941 have been closed. Our order of June 16, 1942, herein suspended such entries made on and after January 1, 1942, however, pending disposition of this matter, and our order herein permanently prohibiting such amortization entries will therefore relate back to that date.

## CONCLUSIONS

13. We are of the opinion and we find and conclude that:

(1) Respondent has failed to show that the amount of $4,166,510.57 should not be charged to its Account 413, with concurrent entries to appropriate accounts; and we further find and conclude that such amount should be charged (debited) to its Account 413;

100 (2) Concurrent with such charge to Account 413, entries should be made (a) to eliminate the amounts presently in-

[23] Section 31.323 of the Commission's Rules and Regulations.

[24] Case 10, Accounting Circular No. 5 (August 16, 1939), Accounting Bulletin No. 1, also made it clear that net amounts in Account 100.4 resulting from debit and credit amounts relating to different transactions, could not be disposed of without direction or approval by the Commission.

cluded in respondent's Account 100.4, associated with New York's acquisitions from A. T. & T. on November 1, 1925, September 1, 1926, and December 31, 1928, by credits to the Account; (b) to eliminate the amounts presently included in Account 172, associated with such acquisitions, with contra entries to Account 171; (c) to adjust the balances in Account 100.1, and the related primary plant Account 231, "Station apparatus," to reflect the original cost of the surviving telephone instruments acquired by New York from A. T. & T. on December 31, 1927, by Debits to those accounts in the amount of the difference between such original cost and the surviving amounts recorded in such Accounts; and (d) to adjust the balance in Account 171, to reflect appropriately the elimination of the intercompany profit or write-up of $4,166,-510.57 resulting from the accounting performed by New York at the time of and during the period since such acquisitions, with respect to and as a result of such acquisitions, by credits to that Account equal to the difference between the amounts debited to Account 100.1 and Account 413, and the amounts credited to Account 100.4;

(3) Respondent has violated the Commission's Accounting Rules and Regulations by failing to reclassify its accounts in accordance with the requirements of such Rules and Regulations, and by making unauthorized entries in its accounts for the purpose of amortizing through charges and credits to its operating expense accounts amounts it has included in its Account 100.4;

(4) Respondent has failed to justify the charges and credits it has made to its operating expense accounts for the purpose of, or in conjunction with, amortizing or otherwise disposing of amounts included in its Account 100.4; and respondent should permanently reverse such charges made on and after January 1, 1942, and should cease and desist from making any such charges or credits to its operating expense accounts, except as otherwise specifically directed, authorized, or approved by the Commission.

14. An appropriate order will issue.

FEDERAL COMMUNICATIONS COMMISSION,
T. J. Slowie,
T. J. SLOWIE, *Secretary.*

Adopted June 22, 1943.
"Released: June 26, 1943. See Section 1.231 of the Commission's Rules of Practice and Procedure."

102 Before the Federal Communications Commission,

Washington, D. C.

P-30—Docket No. 6329

In the Matter of New York Telephone Company, Accounting

*Exceptions of New York Telephone Company to and request for oral argument on the proposed report of the Commission*

July 16, 1943

Comes now the respondent New York Telephone Company and files these exceptions to the proposed report of the Commission issued in the above matter under date of June 26, 1943. Respondent excepts to the findings and conclusions in said Report in the following particulars:

1. Paragraph 4 of said proposed report states:

"Much of the acquired property was in the form of an additional interest in toll lines owned jointly by New York and A. T. & T. Portions of such acquired property had been originally constructed by New York and transferred to A. T. & T. at amounts equivalent to cost of construction."

103 This statement is excepted to for the following reason:

The statement is misleading. The uncontradicted evidence shows that the portions of the acquired property referred to were jointly engineered and were constructed for the joint account of the two companies (R. 56–59).

2. Paragraph 4 of said proposed report states:

"In accounting for the transactions the property acquired by New York was retired on the books of the Long Lines Department, at what A. T. & T. considered to be its book cost to A. T. & T. in the amount of $5,134,342.49; and an amount of $820,452.93 was charged (debited) to the depreciation and amortization reserve accounts of the Long Lines Department as the estimated allocation of the book reserves of the Long Lines Department related to that property. The amount paid by New York to A. T. & T. was, therefore, $1,659,551.91 in excess of the book cost less the related depreciation and amortization reserves, as reflected on the books of A. T. & T. On December 31, 1927, New York acquired certain telephone instruments from A. T. & T. The instruments acquired consisted of all of the principal operating parts of the telephone subscribed stations (receivers, trans-

mitters and induction coils) in use at the time by New York. The amount paid by New York to A. T. & T. was $6,661,238.91. In accounting for this transaction A. T. & T. retired the instruments on its books at what it considered to be book cost to it, in an amount of $8,135,224.98; and an amount of $3,980,944.73 was charged (debited) to its depreciation reserve account for
104 telephone instruments as the estimated allocation of such reserve related to those instruments. The amount paid by New York to A. T. & T. was, therefore, $2,506,958.66 in excess of the book cost less the related depreciation reserve, as reflected on the books of A. T. & T."

This statement is excepted to for the following reason:

The statement is irrelevant to any issue properly and duly raised by the Commission's order initiating this proceeding and is irrelevant to the order to show cause and the Commission is without authority in law to consider the same even if true. Aside from the issue as to the fair and reasonable value of the property acquired (which issue as respondent's answer pointed out is necessarily raised by the order to show cause), the only issue fairly raised by the Commission's order to show cause was the propriety of respondent's accounting entries at the time of and subsequent to said acquisitions.

3. Paragraph 5 of said proposed report states:

"At the time of the respective acquisitions from A. T. & T., referred to above, New York recorded in its plant accounts as cost of telephone plant purchased the amounts paid to A. T. & T. No entries were made in New York's depreciation or amortization reserve accounts in connection with such acquisitions. Nor were special depreciation rates thereafter applied to the amounts recorded in New York's plant accounts with respect to such acquired property, but the current depreciation rates applicable to the respective classes of plant were applied to such amounts as long as such property remained in service."

105 This statement is excepted to for the following reasons:

(a) The statement is misleading in that it implies that in determining the depreciation rates applicable to the respective classes of plant involved the New York Company did not take into consideration the fact that property acquired had already spent part of its service life. Such is not the case. The undisputed evidence shows that consideration was given to such factor in computing the depreciation rates and the rates thereafter used were deemed adequate after giving effect to the shorter life of the property acquired (R. 311–314).

(b) The statement ignores the facts shown by the undisputed evidence that respondent's depreciation reserve account is in all

respects adequate to meet its reserve requirements (R. 122, 1470–1473).

(c) No provision of the effective accounting system required the application of special depreciation rates to the property acquired.

4. Paragraph 6 of said proposed report states:

"The system further provides that Account 100.4 'Telephone plant acquisition adjustments,' shall include amounts 'representing the difference between (1) the amount of money actually paid (or the current money value of any consideration other than money exchanged) for telephone plant acquired, plus preliminary expenses incurred in connection with the acquisition; and (2) the original cost of such plant, governmental franchises and
106 similar rights acquired, less the amounts of reserve requirements for depreciation and amortization of the properties acquired.' 'Original cost' as used in Accounts 100.1 to 100.4, inclusive, is defined in the System of Accounts by Section 31.01-3 (x) of the Rules and Regulations as 'the actual money cost of (or current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to the public use, whether by the accounting company or by predecessors.'"

Paragraph 7 of said proposed report states:

"An attempt was made to determine the amounts of the requirements for depreciation and amortization of such surviving plant, necessary in addition to the future accruals over the estimated remaining life at the current depreciation rates of the respective plant classes, and an amount of $271,280.98 was transferred in 1937 from New York's Account 171, 'Depreciation reserve,' to its Account 172, 'Amortization reserve.' Neither this amount nor any other amount was subtracted from the assumed original cost of such surviving plant as the reserve requirements for depreciation and amortization of such plant in determining the amount included in Account 100.4. No amounts were credited to Account 171 in the process of reclassification. At no time has New York reclassified on an original cost basis the amounts in its accounts associated with its acquisition of the telephone instruments from A. T. & T. in 1927. No amounts were or are included in Account 100.4 as a result of that transaction."

These statements are excepted to for the following reasons:

(a) The statement that respondent at the time of re-
107 classification attempted to determine the amounts of the depreciation requirements for the surviving plant is unsupported by the record. The record shows that respondent transferred from Account 171 to Account 172 an amount which

when supplemented by future amortization charges at uniform rates would provide a reserve equivalent to the amount of the investment carried in Account 100.4 at the termination of the life of the related property (R. 101, 421).

(b) The statements ignore the fact that the accounting system has been construed by the Commission in their brief in the case of A. T. & T. et al. v. U. S., 299 U. S. 232, to mean that the reclassification required by the new system was only a redistribution of the balances in Account 100 existing as of the effective date of the F. C. C.'s new system of accounts, that such construction was adopted by the U. S. Supreme Court and is binding upon the Commission.

(c) The statements are misleading in that they ignore the provisions of Instruction 21 which make it clear that only the amounts in the plant accounts representing an acquisition of a substantially complete telephone system, exchange or toll line should be accounted for on an original cost basis.

(d) The statements ignore the fact shown by the evidence in the record that the telephone instruments are not a substantially complete telephone system, exchange or toll line within the meaning of Instruction 21 and that, therefore, they were required to be accounted for at the price paid (Exs. 69, 70; R. 155–162, 431–433).

108 5. In footnote numbered 12 to paragraph 7 of said proposed report the statement is made:

"In addition, much of the physical property was originally acquired from the Western Electric Company, Inc., a wholly owned subsidiary of A. T. & T. To the extent that Western may have made a profit on the furnishing of such property the 'original costs' so used include an intercompany profit which should ultimately be eliminated."

This statement is excepted to for the following reasons:

(a) The conclusion that the profits of Western Electric should be eliminated from the plant accounts of the New York Company is erroneous for all of the reasons hereinafter stated as to the elimination of profits of the A. T. & T. (see exceptions 6, 7, and 8 herein) made in connection with the transfers in question and for the additional reason that the New York Company had no notice that the propriety of using Western Electric prices was questioned by the Commission (R. 291–294).

(b) There is no proof that Western Electric Company is a wholly owned subsidiary of A. T. & T. The evidence shows that there has been at all times material herein a minority of the stock of Western Electric Company in the hands of the public (R. 294).

(c) Western did not sell its plant or any part thereof to the New York Company. Western is not a utility but a manufactur-

ing and commercial company which has a right to a fair profit from its sales to telephone companies, both Bell System and others.

109 6. Paragraph 5 of said proposed report states:

"The accounting which has been performed by New York with respect to the acquisitions here in question was improper. * * * Since New York was, as it is now, a wholly owned subsidiary of A. T. & T., and therefore fully subject to control by A. T. & T., the intercompany profits to A. T. & T. resulting from the affiliated company transfers of property involved here are fictitious or paper increments, and are as unreal as profits from interdepartmental transactions. The accounting performed by New York with respect to these property transfers resulted in a write-up of its accounts by the amount of such intercompany profits, and, therefore, in the inclusion of purely inflationary items in New York's accounts."

This statement is excepted to for the following reasons:

(a) In this statement and in others throughout the report the purchases of property from A. T. & T. are characterized as a "write-up" and a "fictitious sale" and the accounting as resulting in the inclusion of "inflationary" items or assets in the accounts of the New York Company and in an "unreal" and "fictitious" profit to the A. T. & T. The uncontradicted evidence shows that the purchases in question were necessary to the conduct of important and profitable business of the New York Company and that the New York Company paid no more for the property than the fair and reasonable value at the time of acquisition. (See record references in support of exception 31, infra.)

(b) The conclusion is based upon an enterprise or "eco-
110 nomic unit" theory of accounting which has not been prescribed by any system of accounts. It ignores the fact that the New York Company and the A. T. & T. are separate corporate entities, subject to differing rights and obligations and keeping separate accounts (Exs. 71–79).

(c) The conclusion ignores the fact that the amounts entered in the New York Company's accounts represent the cost to it of acquiring the property in question and that neither the gross nor the net assets of the New York Company were changed by the purchase. The conclusion is contrary to the undisputed evidence that there was no "write-up of its accounts" in any amount (R. 66–69, 430–431).

(d) The conclusion ignores the fact that the accounting performed at the time of acquisition was in strict accord with the provisions of the Interstate Commerce Commission's system of accounts to which the New York Company was then subject.

7. Paragraph 9 of said proposed report states:

"The transfer of the property from the parent A. T. & T. to the subsidiary New York, should not be permitted to convert the excess amounts over A. T. & T.'s net book investment from a fictitious intercompany profit to an investment in assets by New York. Upon consolidation of the affiliated company accounts, such intercompany profits should be eliminated. This was recognized by witnesses presented by New York, who were members of a firm of auditors regularly employed by A. T. &. T."

111 This statement is excepted to for the following reasons:

(a) The statement that upon consolidation of the affiliated company accounts such intercompany profits should be eliminated is irrelevant to the issues in this proceeding. The New York Company does not consolidate its accounts with those of the A. T. & T. For certain special purposes consolidated statements drawn from the accounts of the two companies are prepared but these do not impair the integrity of the separate accounts kept by each corporation (Exs. 71–79).

(b) The New York Company presented only one witness who was a member of a firm of auditors regularly employed by the A. T. & T., Mr. Schaffer. Mr. Schaffer's testimony is consistent and clear that the principles as to the elimination of intercompany profits applicable to consolidated statements do not apply to the accounting for each corporate entity (R. 1443, 1488).

8. Paragraph 9 of said proposed report states:

"If the amounts of such fictitious profits are allowed to remain in New York's accounts they may become real profits to the affiliated group of companies by improper inclusion as a part of the cost of service."

This statement is excepted to for the following reasons:

(a) The record shows that the profit of the A. T. & T. was not fictitious but real (R. 67).

112 (b) The record shows that the profit has not been included in the New York Company's accounts (R. 63–79).

(c) The inclusion by the New York Company in its accounts of the amount paid for the property not in excess of its value properly represents the fact of its investment and to the extent that such fact is relevant in a determination of its rates for service it is properly so considered (R. 63–79, 343).

(d) The cost of the service of the New York Company to the public has been and will be determined in accordance with the laws of the State of New York as to intrastate rates and in accordance with the laws of the United States as to interstate rates, limited respectively by the due process clauses of the Fourteenth and Fifth Amendments of the United States Constitution. There is no evi-

dence that in the past the accounting performed has enabled the New York Company to charge improper rates. On the contrary, the New York Company would have shown, if its evidence and offer of proof on the subject had not been rejected, that its rates since the time of acquisition have been determined under the applicable laws after full disclosure of all of the details of the transfers in question and that the price paid to A. T. & T. did enter into the rate base (R. 1426–1431). There is no evidence that the accounting performed will enable the New York Company to collect improper rates in the future. On the contrary, the Commission's proposed accounting by misrepresenting the facts of the transactions will result in impeding the New York Company in securing proper rates.

113 9. Paragraph 9 of said proposed report states:

"Since transfers of property were made in both directions between New York and A. T. & T. at prices in excess of the net book investment of each transferor company, the combined surplus of the companies was increased, not as a result of any increase in income or property, not as a result of any change in the service rendered, but simply as a result of the accounting based upon fictitious sales and unnecessary transfers of unreal cash profits."

This statement is excepted to for the following reasons:

(a) It is irrelevant and prejudicial. The order to show cause in this proceeding gave no notice that the sale by the New York Company to the A. T. & T. was in question and A. T. & T. Company has not been made a party to this proceeding.

(b) There is no evidence in the record as to the details of the sale from the New York Company to the A. T. & T.

(c) There is no evidence that any of the sales in question were fictitious. On the contrary, such evidence as was permitted to go into the record shows that the sales were actual and were necessary to the efficient telephone operation of each company (31–34, 470–480, 1214–1215).

(d) As pointed out above, the accounting did not result in any unreal profits. No such profits were transferred by either company and the finding by the Commission in that respect is without evidentiary support in the record.

114 10. Paragraph 9 of said proposed report states:

"The inflationary write-ups found herein should, therefore, never have been recorded in New York's accounts, and should now be forthwith eliminated from New York's accounts."

This statement is excepted to for the following reasons:

(a) As is pointed out above, there is no proof that the accounting in question did result in an inflationary write-up. On the

contrary, the uncontradicted evidence shows that there was no such write-up (R. 31–34, 1214–1215).

(b) The evidence shows that the accounting in question was required by the Interstate Commerce Commission's System of Accounts then in effect (R. 63–79, 343. See also record references to exception 31, infra).

(c) The conclusion ignores the fact shown by the evidence that a large part of the property acquired has already been retired from service by the New York Company and the amount of its investment therein eliminated from its accounts at the price paid (Exs. 61, 62, 64, 67).

11. In footnote 16 to paragraph 9 of the said proposed report, it is stated:

"New York's failure to make any credit entries to Account 171 to reflect the reserve requirement for depreciation of acquired property, and to deduct the amount of such reserve requirement from original cost, in determining the amounts includable
115 in its Account 100.4 results in the inclusion of insufficient amounts in that account."

This statement is excepted to for the following reason:

This interpretation of the Commission's System of Accounts is contrary to the interpretation put upon such system of accounts by the Commission in its brief before the United States Supreme Court in A. T. & T. et al. v. U. S., 299 U. S. 232, which interpretation was accepted by the Court in its opinion and is binding on the Commission.

12. Footnote 17 of paragraph 10 of said proposed report contains the statement:

"New York relies heavily on statements of the United States Supreme Court in American Telephone and Telegraph Co. v. U. S. et al., 299 U. S. 232, and the record in that case, with respect to the disposition of items included in Account 100.4. This position assumes that the items in question were properly recorded in Account 100.4. Such items should never have been recorded in that Account."

The last sentence of this statement is excepted to for the following reasons:

(a) The statement is contrary to the provisions of the F. C. C. System of Accounts.

(b) The statement is contrary to the position and interpretation of the requirements of the system of accounts with respect to Account 100.4 made by the Commission in the case above referred to.

116 (c) The statement is contrary to the interpretation of the system of accounts made by the accountants testifying

for the Commission in this proceeding (R. 1151, 1605; R. 1696–1697).

(d) Regardless of the particular accounting prescribed by the Commission, the rule of law announced in statements of the U. S. Supreme Court in A. T. & T. et al. v. U. S. precludes the Commission from compelling the companies to write out of their accounts amounts representing investments in assets of continuing value and the evidence in the record shows that the amounts now in the plant accounts, including Account 100.4, of the New York Company, attributable to the property remaining in service of that acquired in the purchases in question do represent an investment by the New York Company in assets of continuing value.

13. Paragraph 10 of said proposed report, after enumerating certain of the contentions of respondent, states:

"Other contentions are advanced which are either subsidiary to those outlined above or are plainly irrelevant to a determination of the issues in this proceeding."

This statement is excepted to for the following reason:

The Commission failed to specify the "other contentions" to which reference is made. Without attempting to enumerate all the contentions which the respondent makes the respondent
117 excepts to the blanket ruling that all of its contentions, other than those "outlined" by the Commission or which are subsidiary to those "outlined," are irrelevant.

14. Paragraph 4 of said proposed report states:

"A. T. & T. has at all times material to this proceeding controlled New York through its ownership of 100% of New York's Common stock."

Paragraph 10 of said proposed report states:

"The fact of this ownership by A. T. & T., carrying with it the power to control New York, makes the fairness and reasonableness of the 'prices' paid in such a transfer of property between such affiliated companies completely unrealistic. There was and could be no arms'-length bargaining between A. T. & T. and New York with respect to the amounts so paid."

These statements are excepted to for the following reasons:

(a) The implication is made that because of the fact that A. T. & T. owns 100% of New York's common stock the corporate entities of the two companies should be disregarded. This conclusion is erroneous. There is no evidence in the record which supports or tends to support the conclusion that the New York Company is a mere instrumentality of the A. T. & T. The two companies have separate boards of directors, bondholders, creditors, subscribers, etc. (Exs. 71–79; R. 439–449). The New York Company on and after the dates of the acquisitions in question

118 had outstanding 250,000 shares of preferred stock, none of which was owned by the A. T. & T. (R. 707, 1288, Annual Reports of New York Company to I. C. C. and F. C. C. for the years 1925–1942).

(b) To the extent that the Commission's report rests upon the conclusion that the corporate entities of the two companies should be disregarded, the report is without foundation in the evidence and is unauthorized by law.

(c) The conclusion that there can be no fair or reasonable price between affiliated companies is contrary to fact and law. Even assuming, as the Commission does, that there can be no arms'-length bargaining between the A. T. & T. and the New York Company, it does not follow that there can be no sales of property between such companies or that the price agreed upon in such sales cannot be found reasonable when tested by objective standards such as the value of the property transferred.

15. Paragraph 10 of said proposed report states:

"Any method of accounting which results in the inclusion in plant investment accounts of amounts based upon 'values' agreed upon between a wholly owned subsidiary and its parent would nullify accounting from a regulatory standpoint. The full ultimate impact of such inflationary elements in the plant accounts is in time improperly reflected in the depreciation expense account as an alleged operating cost, unless, by proper regulatory requirements, the balance-sheet is cleared, or in the first instance is kept free, of such inflationary elements. Accounting for purposes of efficient regulation of public utilities, must be
119 firmly grounded on the cost principal, and if investment is to have some relationship to the investment dedicated to the public use by an affiliated group of companies, such agreed 'values' must not be allowed to exist as a distortive element in their investment accounts."

This statement is excepted to for the following reasons:

(a) Insofar as it refers to values arrived at by arbitrary agreement of the parties without relation to the true value of the property, the statement has no application to the transfers in question. The question of value is not, in the final analysis, a matter of agreement between the parties but a question of objective fact to be proved by evidence. Such evidence as respondent was permitted to introduce in this proceeding demonstrated that the price which it paid for the property acquired was not more than the property was worth (see record references in support of Exception 31, infra).

(b) The implication that the accounting followed by the New York Company constituted a departure from the cost prin-

ciple of accounting is erroneous. It is undisputed that the New York Company entered the property here in question in its plant accounts at the cost to it (R. 66–69, 430–431). The suggested procedure by the Commission constitutes a departure from the cost principal of accounting and is based upon theories of enterprising accounting, i. e. accounting for an economic unit as distinguished from accounting for an individual company.

(c) The conclusion that the accounting followed by the
120 New York Company would improperly reflect inflationary amounts in its depreciation expense account as an alleged operating cost is in error in view of the fact that cost to the New York Company not in excess of value has been entered in the plant accounts against which depreciation rates are applied (R. 66–69, 430–431: See also record references to exception 31, infra).

16. Paragraph 10 of said proposed report states:

"That the 'value' of property transferred between affiliates can ever be represented by any amount greater than ligitimate net book investment to the original affiliated owner is at best an illusion born of accounting aberrations existing during the period of the 1920's."

This statement is excepted to for the following reason:

The statement is erroneous in fact and law. There is no necessary relationship between the value of the property at the time of transfer and the cost to the original affiliated owner. If the statement is intended to mean that fundamental accounting principles prohibit any purchase price, not in excess of the value of the property transferred, from being reflected on the books of the purchasing company, the statement is contrary to law and without substantial support in the evidence.

17. Paragraph 10 of said proposed report, speaking of the value of property purchased from an affiliated company, states:
121 "Certainly such 'values' cannot be represented by an estimate of such an inherently speculative nature as reproduction cost less depreciation."

This statement is excepted to for the following reason:

The statement is contrary to fact and to the law as it existed at the time of the acquisitions in question and as it exists today.

18. Footnote 18 of paragraph 10 of said proposed report states:

"The highly speculative nature of estimates of reproduction cost less depreciation is illustrated by the following defects in respondent's showings and offers of proof in this respect: The reproduction cost new figures were based in part upon prices of the Western Electric Company, Inc., another wholly owned subsidiary of A. T. & T., without elimination of Western Elec-

tric profits. Such reproduction cost figures were based upon costs to A. T. & T. rather than the generally lower costs of New York. The amount deducted for depreciation was inadequate in that there was a failure to make adequate allowance for obsolescence and inadequacy. The character of this latter proof was such that it is entitled to little if any weight. The amount paid for the instruments was based upon Western Electric prices with an arbitrary deduction of 20% from the gross calculated price. The 20% was grossly inadequate when compared with the depreciation reserve of approximately 50% accrued by A. T. & T. as depreciation applicable to the instruments."

122 This statement is excepted to for the following reasons:

(a) Respondent was told by the hearing Commissioners that the question of Western Electric prices would not be gone into in this proceeding (R. 291–294).

(b) The evidence shows that the reproduction cost figures were not based solely upon the cost of the A. T. & T. or those of the New York Company but in every instance were based upon the costs which the engineers estimated would be incurred at that time irrespective of which of the two companies performed the work. There is no evidentiary support in the record for the statement that the New York Company costs were generally lower than those of the A. T. & T. In the comparatively few instances in which higher unit costs as developed from the experience of the A. T. & T. were used rather than lower unit costs of the New York Company, the record shows that the reason the A. T. & T. unit costs were used was that they had been developed from construction work reflecting the conditions under which the property being purchased would be constructed while the New York Company unit costs were developed from construction work under different conditions (R. 369, 374–377).

(c) The statement that there was an inadequate allowance made for obsolescence and inadequacy has no support in the evidence.

(d) The statement that the 20% deduction from prices for the instruments new was inadequate when compared with the depreciation reserve at the A. T. & T. is misleading. The evi-
123 dence shows that the 20% deduction was greater than the depreciation existing in the instruments (Exs. 19, 48, 51; R. 492–500, 908–934, 1079–1083). The value of the instruments was properly determined by deducting such existing depreciation from the prices new rather than by deducting the depreciation reserve which the A. T. & T. had accumulated against such instruments.

19. Paragraph 10 of said proposed report states:

"Respondent's assertions as to the method of accounting followed at the time of the property acquisitions here involved being in

accordance with accounting rules and practices prescribed by the Interstate Commerce Commission and in effect at that time are not supported by the reord. There is nothing in the Uniform System of Accounts for Telephone Companies, effective January 1, 1913, prescribed by the Interstate Commerce Commission and in effect during the period 1925 through 1928, requiring or authorizing the recording of property acquisitions from affiliates at any amount greater than the net book investment of the transferring affiliate. Instruction 13 of that system of accounts, relied upon by New York, was not intended to be applicable to transfers of property between affiliates such as those involved here."

The statement is excepted to for the following reasons:

(a) The statement that respondent's assertion of compliance with the accounting rules of the I. C. C. is not supported by the record implies that the question turns upon a disputed issue
124 of fact. This implication is incorrect. There is no dispute as to the method of accounting followed at the time of the property acquisitions here involved. Such accounting complied literally with the method prescribed in Instructions 10 and 13 of the I. C. C.'s System of Accounts for Telephone Companies, effective January 1, 1913, the only disputed question being whether those instructions were confined to purchases of property from nonaffiliates. Since the pertinent provisions of the I. C. C. System of Accounts are clear and unambiguous their interpretation is a ~~matter of law, not of fact.~~ Consequently the receipt by the hearing Commissioners over objection of respondent's counsel of extrinsic evidence to interpret such provisions and their refusal to allow respondent to introduce rebuttal evidence was improper (659–660, 1405–1410, 1421–1426). The Commission's interpretation of the applicable accounting requirements of the I. C. C. is erroneous as a matter of law.

(b) There is no evidence that the I. C. C. intended that Instructions 10 and 13 be limited to purchases from non-affiliates. On the contrary the evidence shows that those instructions were intended to mean what they said (Ex. 31; R. 1410, 1517–1518, 1665, 1793–1795, 1912–1913, 1594–1595, 1869–1876).

(c) The record shows that at the times in question there was neither any provision of the I. C. C. System of Accounts nor any accounting rule prescribed by such Commission which required or permitted different accounting for purchases from affiliated companies than that prescribed or permitted for purchases from nonaffiliated companies (Ex. 31; R. 1410, 1517–1518, 1665, 1793–1795, 1912–1913, 1594–1595, 1869–1876).

125 20. Footnote 19 of paragraph 10 of said proposed report states:

"As early as 1914, and in subsequent correspondence, the New England Telephone and Telegraph Company, an associated Bell System company, and A. T. & T. requested rulings by the Interstate Commerce Commission as to whether Instruction 13 of the I. C. C. system of accounts applied to the accounting for transfers of property between affiliated companies of the Bell System, the companies contending that it did not. The Interstate Commerce Commission replies stated specifically that instruction 13 was not intended to apply to the affiliated company transfers submitted to it."

This statement is excepted to for the following reason:

The statement is an erroneous representation of the contents of the correspondence in question. The Bell System companies in these letters did not obtain rulings or interpretations by the Interstate Commerce Commission. In every instance but one they merely requested a waiver of the enforcement of such provisions in the circumstances of certain specified transfers. In that one case the company requested the adoption of a general rule differing from that provided in the system of accounts applicable to all transfers where certain conditions were met, but its request for such a rule was refused (Exs. 26–39).

21. Paragraph 10 of said proposed report states:

"As we read the provisions of the Uniform System of Ac-
126 counts for Telephone Corporations prescribed by the Public Service Commission, Second District, State of New York, effective January 1, 1912, as amended on March 17, 1921, the accounting performed by New York with respect to the property acquisitions here involved was contrary to such provisions."

This statement is excepted to for the following reasons:

(a) The Federal Communications Commission has no power to interpret or enforce the System of Accounts of the New York Public Service Commission. Its attempt to do so is, therefore, beyond its jurisdiction and contrary to the Communications Act.

(b) If this statement is intended to imply that the New York Company violated the System of Accounts prescribed by the Public Service Commission the statement is erroneous for the reason that the New York Company, being subject to the provisions of the System of Accounts prescribed by the Interstate Commerce Commission, was not subject to the provisions of the System of Accounts prescribed by the New York Public Service Commission above referred to.

(c) The evidence in the record does not support the conclusion that there is a "substantial identity of interest" between the New York Company and the A. T. & T. within the meaning of the rule of the New York Public Service Commission quoted in foot-

note 20 to paragraph 10 and referred to in the above quoted statement of the proposed report.

(d) The reference by the Commission to this rule in the text of its proposed report (whether as an additional ground
127 for any or all of its conclusions, or as a gratuitous comment) is improper in view of (1) the refusal of the hearing Commissioners to permit respondent to offer proof of the federal commissions' exclusive accounting jurisdiction (R. 1341–1357) and (2) of the refusal of the hearing Commissioners of either Commission in this proceeding to inform respondent's counsel upon his request therefor, of their respective Commissions' claims on the jurisdictional issues thus raised (R. 1343, 1355–1357).

22. Paragraph 11 of said proposed report states:

"Respondent asserts that insofar as amounts in its accounts with respect to the property which was acquired from A. T. & T. have been retired from New York's books the amounts of write-ups or inflationary items have been removed from its accounts, and that therefore no charges to surplus are now necessary or appropriate to eliminate such amounts. But the credits to plant accounts and debits to reserve accounts made by New York to reflect the retirement of portions of the acquired property did not remove the inflationary items from its accounts. Those items are still included in its accounts, either in its Account 100.4, or as a deficiency in its depreciation reserve Account 171, or a combination of both. The deficiency in New York's depreciation reserve account results from the existence of debits made to ~~and included~~ in such reserve account, in recording the retirement of the acquired property, in amounts in excess of the original cost to A. T. & T. of such retired property less the related depreciation reserves. These debit amounts were included in New York's depreciation reserve account despite the fact that insufficient
128 credits have been made to such reserve account for purposes of retirement of such property."

The statement is excepted to for the following reasons:

(a) Respondent has not asserted and does not admit that there have been any "write-ups" or "inflationary items" entered in its accounts.

(b) There is no evidence in the record tending to support the conclusion of the Commission that the credits to its plant accounts and debits to its reserve account made by the New York Company upon retirement of portions of the acquired property did not remove from its accounts the amounts originally entered therein attributable to the plant purchased, even if such amounts had been inflationary.

(c) There is no evidence in the record to support the statement that there is a deficiency in the New York Company's depreciation

reserve account. On the contrary, the uncontradicted evidence tends to show that there is a surplus in such reserve account (R. 122).

(d) The company's offer of detailed proof as to the adequacy of its reserve was erroneously rejected by the Commission as irrelevant to the issues in the case (Ex. 65, R. 1254–1262, 1269).

(e) There is no evidence in the record supporting or tending to support the assertion that insufficient credits have been made to such reserve account for the purposes of retiring the property.

129 (f) While there is no evidence in the record to show what depreciation had been accrued against the particular items of property purchased and subsequently retired, such absence of proof does not warrant the conclusion that insufficient credits have been made to the reserve account. The Company kept no separate reserve for individual items of plant or even for classes of plant and the rates for accruals credited to the reserve are and have in the past been computed on an average basis. The evidence shows that those rates took into consideration the fact that property acquired had already served part of its useful life (R. 306–315).

(g) The conclusion that an adjustment should be made to depreciation reserve by reason of the acquisitions in question regardless of the over-all adequacy of the reserve is erroneous. An order directing such an entry would be arbitrary, would constitute retroactive accounting and would be in violation of the Communications Act of 1934 and the due process clause of the Fifth Amendment of the United States Constitution.

(h) The conclusion that the respondent's depreciation reserve account should be increased despite the adequacy of such reserve account, is contrary to law. Such an order would be an attempt, in the guise of an accounting regulation, to interfere unlawfully with the management of the company and would be beyond the jurisdiction of the Commission under the provisions of the Communications Act of 1934 and in violation of the due process clause of the Fifth Amendment of the United States Constitution.

130 23. Footnote 21 of paragraph 11 of said proposed report states:

"In cases where telephone plant was retired, and sufficient depreciation had not been provided by credits to the depreciation reserve account, instruction 23 of the 1913 Interstate Commerce Commission System of Accounts required that the amount of deficiency be written off through charges to Account 413, 'Realized Depreciation not Covered by Reserves,' a Corporate Surplus or Deficit account. No such charges to Account 413 were made by respondent in connection with its retirement of any of the acquired

property involved herein. This Commission's prescribed Account 413, 'Miscellaneous debits to surplus,' among other things, serves the same purpose as the I. C. C. system's Account 413 and Instruction 23."

This statement is excepted to for the following reasons:

(a) There is no evidence in the record which shows that Instruction 23 had application to a "deficiency" in credits to the depreciation reserve for particular property. The instruction therefore has not been shown to have any applicability to the accounting involved in the present proceeding.

(b) Account 413 of the F. C. C. System of Accounts does not require the companies subject to such System of Accounts to make charges to surplus where the amount of depreciation accrued against particular items of plant was not sufficient to cover the retirement of such items of plant.

131 24. Paragraph 12 of said proposed report states:

"New York's amortization of the debit amounts included in its Account 100.4 by charges to its operating expense accounts, and its amortization of the credit amounts included in that account by credits to its operating expense accounts, were begun in 1938 without any prior direction, authorization, or approval having been given to New York by this Commission. * * * No direction, authorization or approval has ever been given to New York by this Commission to dispose of amounts in Account 100.4 by amortization through charges or credits to Account 614, or any other operating expense account. As our findings herein show, no such direction, authorization, or approval would have been appropriate. We find that the amortization through operating expenses of the amounts included in New York's Account 100.4, which amortization was begun by New York in 1938, was in violation of the Commission's Accounting Rules and Regulations, particularly Subsection (c) of Account 100.4, Account 614, and Order No. 60."

This statement is excepted to for the following reasons:

(a) The conclusion that the amortization referred to was commenced without any prior direction, authorization, or approval of the Commission is not supported by the evidence. On the contrary, the evidence shows that the amortization was made pursuant to a plan approved by the Commission (Ex. 4, R. 102–105; 109–131).

(b) There is no evidence in the record to support the

132 conclusion that approval of such plan of amortization was not appropriate. The record shows that under the "binding construction" (sometimes referred to in the record as a "stipulation" or "interpretation") filed by the Commission with the United States Supreme Court in A. T. & T. et al. v. United

States, 299 U. S. 232, such approval was required to be given upon a showing that the amounts being amortized represented an investment in assets of continuing value definitely attributable to depreciable telephone plant (Ex. 3). Respondent in his proceeding was denied an adequate opportunity to show that the amounts entered in its Account 100.4 did represent an investment in assets of continuing value definitely attributable to depreciable telephone plant with respect to property acquired from A. T. & T. (R. 504, 538, 606, 703, 706, 712, 748, 887–906, 1032–1035, 1282).

(c) The conclusion that Commission approval of the amortization of amounts in Account 100.4 would not be appropriate is broad enough to include amortization of amounts in such account attributable to acquisitions from telephone companies other than the A. T. & T. As to such acquisitions respondent has been given no opportunity to show that the amounts in Account 100.4 attributable to such acquisitions represent an investment in assets of continuing value definitely attributable to depreciable telephone plant.

(d) The conclusion that the amortization begun by the New York Company in 1938 was in violation of Subsection (c) of Account 100.4 Account 614, and Order No. 60, rests upon the assumption that such amortization was begun without the prior approval of the Commission. This is contrary to the evidence in the record (Ex. 4, R. 102–105, 109–131).

133 25. Footnote 24 of Paragraph 12 of said proposed report states:

"Case 10, Accounting Circular No. 5 (August 16, 1939), Accounting Bulletin No. 1, also made it clear that net amounts in Account 100.4 resulting from debit and credit amounts relating to different transactions, could not be disposed of without direction or approval by the Commission."

This statement is excepted to for the following reason:

It is irrelevant to any of the issues in this proceeding.

26. Paragraph 2 of said proposed report states:

"Although a hearing is not a prerequisite to action by the Commission under Section 220 of the Act, a hearing was ordered, with provision for its conduct jointly with hearings involving similar matters before the New York and Connecticut State Commissions."

This statement is excepted to for the following reasons:

(a) The conclusion of law that a hearing is not a prerequisite to action by the Commission under Section 220 of the Act is erroneous insofar as it refers to action such as suggested in the proposed report. Such a hearing is required by the provisions

of the Communications Act of 1934 and by the due process clause of the Fifth Amendment of the United States Constitution.

134 (b) While the statement that a hearing was ordered is correct, the implication that a fair and impartial hearing such as is required under the statute and the provisions of the Federal Constitution has been granted is erroneous. The respondent has been denied a fair hearing in the following respects among others:

(1) The hearing Commissioners prejudged the issues and demonstrated partiality and bias in their rulings (R. 2038, 2087, Record references to exception 26 (b) (2) to (b) (6), infra).

(2) Respondent was denied the opportunity to introduce competent, material and relevant evidence upon the issues in this proceeding (R. 504, 538, 606, 703, 706, 712, 748, 887–906, 935–943, 952–979, 993, 1032–1035, 1282, 1254–1262, 1269, 1426, 2107, 345, 2122. Exs. 15, 17, 20, 47, 49, 50, 65, 66, 68).

(3) The Commission excluded evidence offered by the company while admitting evidence of a similar character offered by Commission counsel (R. 1112–1121, 1404–1410, 1724, 1889, 1948).

(4) The Commission permitted the introduction as evidence of incompetent and highly prejudicial statements of witnesses presented by Commission counsel over objections of respondent (1122–1159, 1531–1532).

(5) Respondent was not permitted to mark for identification documents which were relevant and which were not identifiable or sufficiently identifiable by statement, thereby denying respondent an opportunity to preserve the rulings of the hearing Commissioners and the exceptions of respondent therefor for purposes of review by the full Commission and the courts (R. 1648–1652, 2038–2043, 2114–2126).

135 (6) Respondent's counsel was in certain instances not permitted to state the grounds for the exceptions which respondent took to rulings by the examining Commissioners (R. 1795–1797, 1955–1956).

27. Paragraph 2 of said proposed report states:

"Under Section 220 of the Act respondent has the statutory burden of justifying the accounting entries questioned by the Commission."

Paragraph 13 of said proposed report states:

"Respondent has failed to show that the amount of $4,166,-510.57 should not be charged to its Account 413, with concurrent entries to appropriate accounts; and we further find and conclude that such amount should be charged (debited) to its Account 413;"

These statements are excepted to for the following reasons:

(a) The provision contained in the Communications Act of 1934 as to burden of proof was not contained in the Interstate Commerce Act and does not apply to accounting entries made prior to the effective date of the Communications Act.

(b) The burden imposed upon the respondent by Section 220 is limited to the burden of going forward with the evidence. This burden was met by respondent to the extent that it was permitted by the hearing Commissioners so to do.

(c) The record hearings and the proposed report show
136 that respondent was not given an adequate opportunity to go forward with the evidence, that the Commission gave no consideration to the evidence which was introduced by respondent and prevented it from introducing other relevant and competent evidence. (See record citations to exception 26.)

(d) The implication that the respondent has the burden of proving that the accounting entries suggested by the Commission should not be made is erroneous. The burden rested upon the Commission to show that the entries which it proposed are required by the valid provisions of the effective system of accounts or other provisions of law. This burden has not been sustained. On the contrary uncontradicted evidence shows that no amount should be charged to respondent's account 413. The evidence shows that the amounts attributable to the purchase in question reflected in respondent's asset accounts represent an investment in assets of continuing value and that the respondent's depreciation reserve is adequate. (See record citations to exception 31.)

(e) The conclusion of the Commission that the charge of \$4,166,510.57 should be charged to respondent's account 413 is based upon the conclusion that the accounting of the New York Company at the time of the acquisition in question was improper and not in accord with the uniform system of accounts prescribed by the I. C. C. and upon the further conclusion that the retirement of the amounts recorded in its plant accounts at the time the property was retired from service would not to that extent remove alleged "inflationary items." Since the subsidiary conclusions as heretofore specified are erroneous, the ultimate conclusion is without foundation in the record.

137 (f) Any order directing such a charge to respondent's Account 413 would compel the respondent to misstate its present and future financial condition and operations, would prevent it from keeping proper and accurate accounts, would be so at odds with fundamental principles of correct accounting as to be arbitrary, would interfere unlawfully with respondent's right to manage its own business, would be without authority in the Communications Act of 1934, as amended, and would deprive respond-

ent of its property in violation of the due process clause of the Fifth Amendment of the United States Constitution.

28. Paragraph 13 of said proposed report states:

"Concurrent with such charge to Account 413, entries should be made (a) to eliminate the amounts presently included in respondent's Account 100.4, associated with New York's acquisitions from A. T. & T. on November 1, 1925, September 1, 1926, and December 31, 1928, by credits to the Account; (b) to eliminate the amounts presently included in Account 172, associated with such acquisitions, with contra entries to Account 171; (c) to adjust the balances in Account 100.1 and the related primary plant Account 231, 'Station apparatus,' to reflect the original cost of the surviving telephone instruments acquired by New York from A. T. & T. on December 31, 1927, by Debits to those accounts in the amount of the difference between such original cost and the surviving amounts recorded in such Accounts; and (d) to adjust the balance in Account 171, to reflect appropriately the elimination of the inter-company profit or write-up of $4,166,510.57 resulting from
138 the accounting performed by New York at the time of and
during the period since such acquisitions, with respect to and as a result of such acquisitions, by credits to that Account equal to the difference between the amounts debited to Account 100.1 and Account 413, and the amounts credited to Account 100.4;"

This statement is excepted to for the following reasons:

(a) This conclusion is based upon the conclusions that the accounting at the time of the original acquisitions was improper and contrary to the Uniform System of Accounts prescribed by the Interstate Commerce Commission and upon the further conclusion that the retirement of the amounts recorded in respondent's plant accounts at the time the property was retired from service did not, to that extent, remove the alleged "inflationary items." Since the subsidiary conclusions as heretofore specified are erroneous the ultimate conclusion is without foundation in the record.

(b) Any order directing the accounting entries described in the above statement would compel the respondent to misstate its present and future financial condition and operations and would be so at odds with fundamental principles of correct accounting as to be arbitrary, would interfere unlawfully with respondent's right to manage its own business, would be without authority in the Communications Act of 1934, as amended, and would deprive respondent of its property in violation of the due process clause of the Fifth Amendment of the United States Constitution.

139 29. Paragraph 13 of said proposed report states:

"Respondent has violated the Commission's Accounting Rules and Regulations by failing to reclassify its accounts in ac-

cordance with the requirements of such Rules and Regulations, and by making unauthorized entries in its accounts for the purpose of amortizing through charges and credits to its operating expense accounts amounts it has included in its Account 100.4";

This statement is excepted to for the following reason:

The conclusion that respondent has violated the Commission's accounting rules and regulations is unsupported by the evidence in the record and is contrary to such evidence. (See record citations to exceptions 11, 23, and 24.)

30. Paragraph 13 of said proposed report states:

"Respondent has failed to justify the charges and credits it has made to its operating expense accounts for the purpose of, or in conjunction with, amortizing or otherwise disposing of amounts included in its Account 100.4; and respondent should permanently reverse such charges made on and after January 1, 1942, and should cease and desist from making any such charges or credits to its operating expense accounts, except as otherwise specifically directed, authorized, or approved by the Commission."

140 This statement is excepted to for the following reasons:

(a) There is no evidence in the record supporting or tending to support this conclusion. On the contrary, uncontradicted evidence shows that the amounts in Account 100.4 attributable to plant acquired in the three acquisitions from the A. T. & T. represent an investment in assets of continuing value definitely attributable to depreciable telephone plant and therefore under the "binding construction" filed in the United States Supreme Court in A. T. & T. et al. v. U. S., 299 U. S. 232, the amortization of such amounts through operating expenses is appropriate, and such amortization which has been made should not be reversed, and respondent should be permitted to continue the amortization of such amounts through operating expenses. (See record citation to exception 31.)

(b) As to the amounts in Account 100.4, attributable to plant acquired from telephone companies other than the A. T. & T., respondent has been denied an opportunity to show that these amounts represent an investment in assets of continuing value definitely attributable to depreciable telephone plant, and until such opportunity is afforded, respondent should not be required to reverse any amortization of such amounts, and should not be required to cease or desist from making such charges through its operating expense accounts in the future.

(c) Any order directing respondent to reverse permanently the charges referred to or prohibiting respondent from making such charges in the future would compel the respondent to mis-
141 state its present and future financial condition and operations and would be so at odds with fundamental princi-

ples of correct accounting as to be arbitrary, would interfere unlawfully with respondent's right to manage its own business, would be without authority in the Communications Act of 1934, as amended, and would deprive respondent of its property in violation of the due process clause of the Fifth Amendment of the United States Constitution.

31. Respondent excepts to the failure of the Commission to adopt each of the following findings of fact proposed by the respondent in this proceeding.

1. The New York Telephone Company (hereinafter called the New York Company) is and at all times mentioned herein was lawfully engaged in intrastate, interstate, and foreign communication by wire or radio within the State of New York and elsewhere. Its average annual operating revenues have exceeded $50,000, at all times mentioned herein.

2. The Interstate Commerce Commission from January 1, 1913 until July 11, 1934 (the effective date of the Communications Act), and the Federal Communications Commission from July 11, 1934, to date, have prescribed the forms of accounts of and the methods of accounting to be followed by the New York Company (R. 1435–1436).

3. For several years prior to 1925 both the New York Company and the American Telephone and Telegraph Company (hereinafter called the American Company) owned and operated intrastate toll lines in the State of New York (R. 475).

142 4. The New York Company and the American Company at all times mentioned herein have been separate and distinct corporate entities and have had separate directors, officers, employees, bondholders, creditors and subscribers (Exs. 71–78).

5. The intrastate toll business handled by the American Company over its intrastate toll lines in the State of New York prior to 1925 was a profitable portion of the total intrastate telephone business in the State of New York and the transfer of such business was reasonable and proper both as to the New York Company and as to its subscribers (R. 475–480).

6. On June 1, 1925 and November 1, 1925, the American Company transferred to the New York Company a large part of its intrastate toll business in the State of New York (R. 31–33).

7. As of November 1, 1925, the American Company sold to the New York Company for a consideration of $5,831,884.78 a portion of its intrastate toll lines needed to handle the intrastate toll business transferred to the New York Company in 1925 (R. 31–33, 62).

8. As of September 1, 1926, the American Company transferred to the New York Company the remaining portion of its intrastate toll business and in connection therewith sold to the New York

Company for a consideration of $97,310.39 the additional intrastate toll lines required to handle that business (R. 34).

9. As of December 31, 1928, the American Company transferred to the New York Company a portion of its interstate toll business in the State of New York and in conjunction there-
143 with sold to the New York Company for a consideration of $44,246.30 the portion of an interstate toll line needed to handle certain of that business (R. 1214–1215).

10. The major classes of plant included in the purchases described in Findings Nos. 7, 8, and 9 consisted of poles, crossarms, guys and anchors, aerial wire and cable, underground cable, loading coils, conduit and right-of-way (Ex. 1).

11. From January 1, 1913, to January 1, 1933, the effective System of Accounts prescribed by the Interstate Commerce Commission for telephone companies subject to the Interstate Commerce Act and having average annual operating revenues in excess of $50,000, provided as follows:

"13. PLANT AND EQUIPMENT AND OTHER PROPERTY PURCHASED.—When any property in the form of a going or completed plant is purchased, an appraisal of the property so acquired should be made, and the different constituent elements of the plant (and equipment, if any) or other property acquired should be appraised at their structural value; that is to say, at the estimated cost of replacement or reproduction less deterioration to the then existing conditions through wear and tear, obsolescence, and inadequacy. If the actual money value of the consideration given for the plant or other property was at the time of the acquisition in excess of such appraised value, the excess should be charged to account No. 204, 'Other Intangible Capital,' and the appraised values of the constituent elements should be charged to the appropriate fixed capital accounts as hereinafter designated. If the actual money value of the consideration given was not in excess of such appraised value, such actual money value should be
144 distributed through the said accounts in proportion to the said appraised value of the constituent elements appropriate to the respective accounts (R. 1435–1436). * * *"

12. In the instance of each purchase described in Findings Nos. 7, 8, and 9 an appraisal was made by the New York Company of the property purchased and the constituent elements of the plant at appraised structural value as defined in Instruction 13 set forth in Finding No. 11 (Ex. 1, R. 1214–1215).

13. The appraisals were made by experienced and well qualified inspectors and engineers using the following method:

Traffic engineers estimated the number of circuits which would be needed to handle the business transferred. Plant engineers then determined what plant would be required from the American

Company in order to obtain the circuits which the traffic engineers estimated would be needed. A check by plant employees was made which determined that the plant which it was proposed to purchase from the American Company corresponded with the plant found in the field. Reproduction new unit costs for each item of plant being purchased were developed by appraisal engineers using current prices for material, labor and overhead costs. The unit costs thus developed were then applied against the quantities of plant as determined by the plant engineers to obtain the reproduction cost new of the plant needed.

To obtain the deduction for deterioration, a field inspection of the property was made and the extent of deterioration
145 due to wear and tear observable and calculable was noted
and recorded. Plant engineers familiar with the character of the property being purchased and with any prospective retirements of such property estimated the quantity which would be retired for any reason other than wear and tear, sooner than property being built for similar purposes at the time of purchase. Plant which it was estimated would be retired within a year from the time of acquisition was not purchased but rented. Other plant which it was estimated would have a shorter life than normal was purchased but the estimated deterioration from reproduction cost new by reason of these factors was properly calculated and recorded. The total deduction made from estimated reproduction cost new was obtained by adding the computed amount for deterioration from wear and tear and the computed allowance for short life plant (R. 36, 44–47, 272–306, 356–367, 526–572, 577–645, 713–774, 776–872, 881–886, 1170–1219).

14. The price paid by the New York Company for the toll plant purchased as above stated was in each instance the structural value as defined in Instruction 13 set forth in Finding No. 11 (R. 66–68, 310).

15. The total amount paid by the New York Company for the toll lines purchahed was distributed through the plant accounts in proportion to the appraised value of the constituent elements appropriate to the respective accounts (R. 66–69).

16. For many years prior to December 31, 1927, the American Company contracted to and did supply and maintain for the New York Company three small but essential parts of the telephones used by the New York Company in its service, namely, the
146 transmitters, receivers and induction coils, known collec-
tively as "the instruments." For this and many other services the New York Company paid the American Company a specified percentage of its gross revenues (R. 160–163, 483–485).

17. The instruments described in Finding No. 16 did not comprise a substantially complete telephone system, exchange or toll line (Exs. 69, 70, R. 155–162, 431–433).

18. On December 31, 1927, the American Company sold to the New York Company the instruments which the New York Company had in service or in supplies on that date, for a total consideration of $6,661,238.91. The American Company thereupon discontinued its service of supplying such instruments after December 31, 1927, and the percentage of gross revenues which the New York Company was required to pay for this and other services under the license contract was reduced from 4% to 2% (Ex. 18, R. 483–487).

19. From January 1, 1913, to January 1, 1933, the effective System of Accounts prescribed by the Interstate Commerce Commission for telephone companies subject to the Interstate Commerce Act and having average annual operating revenues in excess of $50,000, provided in part as follows:

"10. Costs to be Actual Money Costs.—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other
147 than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount charged should be the actual money value of such consideration at the time of the transaction." (R. 1435–1436).

20. Effective July 1, 1916, the Interstate Commerce Commission issued the following interpretation of the System of Accounts described in Findings No. 11 and 19:

"Query.—What items should be classified as 'going or completed plant' under section 13, page 33, 'Plant and equipment and other property purchased' of the Uniform System of Accounts for Class A and B companies?

Answer.—The term 'going or completed plant' is intended to cover only the entire plant of a telephone company or an important unit thereof; such as—

(1) A telephone company as a whole,
(2) An entire central office,
(3) A system of lines and stations within a given area, or
(4) A complete section of toll plant.

The purchase by one company from another of several poles and appurtenances, a switchboard, or other minor portions of plant shall be treated in the same manner as the purchase of materials and supplies; i. e., the purchasing company shall charge the fixed capital accounts at cost, as provided in section 10, page 33, of the Uniform System of Accounts for Class A and B companies." (R. 1435–1436.)

148 21. The price per instrument to the New York Company was based upon the average price charged for new instruments by the manufacturer to the American Company during the first nine months of 1927 less 20%. (R. 512, 943).

22. The percentage deterioration due to wear and tear, inadequacy and obsolescence in the instruments purchased by the New York Company was at the time of such purchase considerably less than the 20% deduction made. (Exs. 19, 48, 51; R. 492–500, 908–934, 1079–1083.)

23. The total amount paid by the New York Company for the instruments in service was entered in its plant accounts (R. 430–431).

24. The amounts entered in the plant accounts of the New York Company as a result of the purchases described in Findings Nos. 7, 8, 9, and 18 constituted investments by the New York Company in assets of continuing value and were attributable to depreciable telephone plant. (R. 31–36, 44–47, 272–306, 356–367, 492–500, 526, 572, 577–645, 713–774, 776–872, 881–886, 908–934, 1079–1083, 1170–1219.)

25. For some years prior to the date of the acquisition of the property as herein described and continuing through until the present time, the New York Company has charged depreciation expense for each class of depreciable plant including the classes of plant purchased and made corresponding credits to its depreciation reserve. The depreciation expense has been determined by applying to the book balances in each account deprecia-
149 tion rates estimated to be adequate under the straight line method on the basis of the service lives and salvage developed by studies of the New York Company's history and experience and such engineering and other information as was available. (R. 75–78, 311–312, 420, 1470–1473.)

26. During this same period the New York Company has credited its plant accounts and debited its depreciation reserve with the cost of plant which has been retired from service. (R. 1139, 1464.)

27. The depreciation and amortization reserves of the New York Company at the present time are more than adequate to meet its estimated reserve requirements. (R. 122, 1470–1473.)

28. Of the toll property purchased from the American Company as of November 1, 1925, September 1, 1926, and December 31, 1928, $3,002,382.48 or 50.26% had been retired from service on January 1, 1937, and $2,971,058.99, or 49.74% remained in service on that date. On January 1, 1942, $3,361,855.08 or 56.28% had been retired from service and $2,611,586.39 or 43.72% remained in service on that date. (Exs. 58, 62, 63, 64; R. 1220–1242.)

29. Of the instruments purchased from the American Com-

pany on December 31, 1927, $4,228,133.50 or 63.47% had been retired from service on January 1, 1937 and $2,433,105.41 or 36.53% remained in service on that date. On January 1, 1942, $6,030,959.78 or 90.54% had been retired from service and $630,279.13, or 9.46% remained in service on that date. (Ex. 67; R. 1360–1377.)

150 30. As of January 1, 1937, the plant accounts of the New York Company were reclassified. The original cost (as defined in Section 3 (S1) of the Federal Communications Commission's Uniform System of Accounts, Class A and Class B Telephone Companies) of property surviving on that date from acquisitions comprising a substantially complete telephone plant purchased since January 1, 1916, where the consideration paid was in excess of $25,000, was placed in Account 100.1 and the difference between original cost and the balance carried in the plant accounts on that date was entered in Account 100.4. Included in the property so reclassified was the surviving toll line plant purchased from the American Company as of November 1, 1925, September 1, 1926, and December 31, 1928. The net amount debited to Account 100.4 by reason of the adjustment of these three purchases was $483,975.83. The instruments surviving from those purchased from the American Company on December 31, 1927, were not included in the property reclassified. (R. 69–72, 102, 431).

31. In the latter part of 1937 and during the year 1938 the New York Company informed the Federal Communications Commission of the reclassification as it was entered on its books, giving the date of purchase, the name of the utility from whom purchased and the amounts which had been transferred to Account 100.4 as a result of the reclassification, together with the method used in determining the same. (Ex. 79; R. 1805–1808.)

32. The reclassification described in Finding No. 30 met with the approval of the Federal Communications Commission and of its Chief Accountant. (Ex. 4, R. 1938, 1951.)

151 33. Mr. C. A. Heiss, Comptroller of the American Company, on behalf of the New York Company and other Bell System Companies wrote to the Federal Communications Commission in 1937 and 1938, proposing a plan to amortize the amounts placed in 100.4 by reason of the reclassification described in Finding No. 30 to Account 614, an operating expense account. (Ex. 4; R. 109–131.)

34. The Federal Communications Commission gave its approval to the plan proposed by Mr. Heiss, which approval continued in effect until the order of the Commission commencing this proceeding. Pursuant to that plan and the approval obtained thereto, the New York Company commenced in December 1938 to amortize the amounts included in Account 100.4 to Account 614 and con-

tinued to do so until ordered to cease such amortization in the order to show cause in this proceeding. (Ex. 4; R. 102–105, 109–131.)

35. The officers, directors, and accounting employees who have been responsible for the accounting performed by the New York Company in respect to and as a result of the acquisitions of telephone property described in Findings Nos. 7, 8, 9, and 18 have understood that such accounting was in accord with the effective systems of accounts and orders of the Interstate Commerce Commission and the Federal Communications Commission. (R. 109–131.)

36. During the years 1938 to 1941, inclusive, the New York Company amortized through operating expenses $64,814.46 of the amounts place in Account 100.4 as a result of the reclassification of the surviving toll property purchased from the Ameri-
152 can Company as of November 1, 1925, September 1, 1926,
and December 31, 1928. (Ex. 12.)

37. The Federal Communications Commission at the request of the United States Supreme Court, October Term 1936, in Case No. 74 entitled "American Telephone and Telegraph Company, et al. v. United States" filed with the court a memorandum adopting the following as a binding construction of the provisions of Account 100.4 of its Uniform System of Accounts for Class A and Class B Telephone Companies:

"The Federal Communications Commission construes the provisions of Telephone Division Order No. 7-C, issued June 19, 1935, pertaining to account 100.4, as follows:

(1) That amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provisions will be made for their amortization.

(2) That when amounts included in account 100.4 are deemed, after a fair consideration of all the circumstances, to be definitely attributable to depreciable telephone plant, provision will be made for amortization of such amounts through operating expenses, through the medium of either account 613 (R. 186) or account 675 (R. 205)." (Ex. 3.)

32. Respondent excepts to the failure of the Commission to adopt each of the following conclusions proposed by respondent in this proceeding:

153 1. The New York Company from January 1, 1913, to
January 1, 1937, was subject to the Uniform Systems of Accounts for Class A and Class B Telephone Companies prescribed by the Interstate Commerce Commission and from Jan-

uary 1, 1937, to date has been subject to the Uniform System of Accounts for Class A and Class B Telephone Companies prescribed by the Federal Communications Commission. During that period it has been prohibited by law from following any other system of accounts except that it has been permitted to keep subaccounts not impairing the integrity of the primary accounts.

2. The New York Public Service Commission at no time since January 1, 1913, has possessed any power or authority to prescribe the forms of the accounts of or the method of accounting to be followed by the New York Company except as to certain subaccounts as described in Conclusion No. 1.

3. The Interstate Commerce Commission System of Accounts for Class A and Class B Telephone Companies effective from January 1, 1913, to January 1, 1933, required that where going or completed plant was purchased, the actual money value of the consideration paid or given therefor should be entered in the fixed capital accounts if not in excess of the structural value of the property acquired. The System of Accounts made no distinction between purchases from affiliated companies and purchases from nonaffiliated companies.

4. The actual money value of the consideration paid for the toll
plant purchased by the New York Company from the
154 American Company as of November 1, 1925, September 1,
1926, and December 31, 1928, was not in excess of the structural value of the property acquired.

5. The instruments purchased by the New York Company from the American Company on December 31, 1927, did not constitute "going or completed plant" as used in Instruction 13 of the Interstate Commerce Commission's Uniform System of Accounts for Class A and Class B Telephone Companies effective January 1, 1913, and did not comprise a "substantially complete telephone system, exchange or toll line" as used in Instruction 21 of the Federal Communications Commission's Uniform System of Accounts for Class A and Class B Telephone Companies effective January 1, 1937.

6. The actual money cost to the New York Company of the instruments purchased from the American Company on December 31, 1927, was not in excess of the fair and reasonable value of the instruments acquired.

7. The accounting performed by the New York Company at the time of and during the period since the four acquisitions of telephone property described in Findings Nos. 7, 8, 9, and 18 with respect to and as a result of such acquisitions has been in accord with the effective systems of accounts and accounting orders prescribed by the Interstate Commerce Commission and the Federal Communications Commission.

8. Any reduction of the investment of the New York Company by a write off to surplus by reason of the accounting performed with respect to and as a result of the transactions described
155 in Findings Nos. 7, 8, 9, and 18 would be retroactive accounting, would constitute a write off of investment by the New York Company in assets of continuing value and would prevent the New York Company from amortizing through operating expenses amounts now in Account 100.4 definitely attributable to depreciable telephone plant and overstate its income.

9. Any reduction of the surplus of the New York Company by reason of the accounting performed with respect to and as a result of the transactions described in Findings Nos. 7, 8, 9, and 18 would be contrary to the Federal Communications Commission's System of Accounts for Class A and Class B Telephone Companies, contrary to the binding construction of that system of accounts filed with the United States Supreme Court, contrary to the provisions of the Communications Act of 1934, contrary to accepted fundamental principles of accounting and would deprive the New York Company of its property without due process of law in violation of the Fifth Amendment of the United States Constitution.

10. The surplus of the New York Company should not be charged with the amount of $4,166,510.57 referred to in the order to show cause herein dated June 16, 1942, or by any amount as the result of its accounting for or in respect of the transactions described in Findings Nos. 7, 8, 9, and 18.

11. The order to show cause in this proceeding should be dismissed, the investigation discontinued, the portion of the order requiring the New York Company to suspend amortization of amounts in Account 100.4 and to cease making such amor-
156 tization through operating expense should be rescinded, and the company should be authorized to continue with the amortization of such amounts through Account 614 as outlined in the plan of amortization proposed to the Federal Communications Commission by Mr. C. A. Heiss as described in Finding No. 33.

Respondent respectfully requests oral argument.

Respectfully submitted.

RALPH W. BROWN,
*Attorney for Respondent,*
*New York Telephone Company.*

EDWARD L. BLACKMAN,
FRANK A. FRITZ,
STEPHEN H. FLETCHER,
*Of Counsel.*

157 Before the Federal Communications Commission, Washington, D. C.

P-30—Docket No. 6329

IN THE MATTER OF NEW YORK TELEPHONE COMPANY, ACCOUNTING

STATE OF NEW YORK,
*County of New York, ss:*

Vincent T. Cummiskey, being duly sworn, deposes and says that on the 15th day of July 1943, deponent being more than 21 years of age, mailed in the United States Postoffice at New York City, New York, copies of the annexed exceptions of New York Telephone Company to and request for oral argument on the proposed report of the Commission in the above-entitled matter with full postage prepaid as follows: Public Service Commission, Mr. Murray G. Tanner, Secretary, State Office Building, Albany, New York; Gay H. Brown, Esq., Counsel, Public Service Commission, State Office Building, Albany, New York; John T. Ryan, Esq., Assistant Counsel, Public Service Commission, 80 Centre Street, New York City; Harry Hertzoff, Esq., Assistant Corporation Counsel, City of New York, Municipal Building, New York City.

VINCENT T. CUMMISKEY.

Subscribed and sworn to before me this 15th day of July, 1943.

HERBERT L. LEIGH,
Herbert L. Leigh,
*Notary Public, New York County.*

N. Y. Co. Clk's No. 249 Reg. No. 352L5; Bronx Co. Clk's No. 27 Reg. No. 124L5; Kings Co. Clk's No. 66 Reg. No. 284L5; Queens Co. Clk's No. 1874 Reg. No. 174L5.

167 United States District Court, Southern District of New York

Civ. 24-211

NEW YORK TELEPHONE COMPANY, PLAINTIFF

*v.*

UNITED STATES OF AMERICA AND FEDERAL RADIO COMMUNICATIONS COMMISSION, DEFENDANTS

Before THOMAS W. SWAN, Circuit Judge, and JOHN W. CLANCY and JOHN BRIGHT, District Judges

Ralph W. Brown, Esq., 140 West Street, New York City; Frank A. Fritz, Esq., 140 West Street, New York City; Henry J. Friendly,

Esq., 31 Nassau Street, New York City; Attorneys for New York Telephone Company.

Honorable James B. M. McNally, United States Attorney for the Southern District of New York, Attorney for the United States of America.

Charles R. Denny, Esq., General Counsel, Federal Communications Commission, New Post Office Bldg., Washington, D. C.

*Opinion*

Aug. 24, 1944

BRIGHT, D. J.:

Defendants move for summary judgment on the ground that there is no genuine issue of fact. Plaintiff asks, at this time, no affirmative relief.

Jurisdiction is not questioned, and is established by Section 402 (a) of the Commissions Act of 1934, 48 Stat. 1064, 1093,
168 47 U. S. C. A. Section 402 (a), and by the Urgent Deficiencies Appropriation Act, 38 Stat. 219, 28 U. S. C. A. Section 41 (28) and Sections 46 and 48.

The action is brought to enjoin and annul an order of the Federal Communications Commission dated December 14, 1943, which directed plaintiff to make certain accounting changes in its books, by reducing its surplus by $4,166,510.57 (the excess of payments by plaintiff to American Telephone & Telegraph Company, which we will call the "American Company," for telephone plant purchased by plaintiff from the latter on November 1, 1925, September 1, 1926, and December 31, 1928, and for telephone instruments so acquired on December 31, 1927) over the amount found by the Commission to represent the net book cost of such acquisitions on the books of the American at the time of such purchase; to restate this investment in plant so acquired; to balance these changes by adding to depreciation reserve $3,879,957.94; and to make other entries in its accounts.

At the time of these acquisitions, the American Company owned all of the outstanding common stock of the plaintiff. There were also outstanding in the hands of the public 250,000 shares of plaintiff's 6½% $100 cumulative preferred stock, and in excess of $132,000,000 of mortgage bonds. All of plaintiff's officers, and at least two-thirds of its directors, were not directors, officers or employees of the American Company. It maintained its own books and records, and its employees, property and business were separate and apart from those of the American Company.

Prior to 1925 the American Company had furnished intrastate and interstate toll service between certain points in New York. In that year it was agreed that such business would be transferred

to plaintiff. In order to accomplish that, plaintiff purchased from the American Company certain toll plant, consisting of tangible property such as poles, wires, serials and underground cable rights of way, etc., as of November 1, 1925, September 1, 1926, and December 31, 1928.

Prior to December 31, 1927, the American Company, as holder of the fundamental Bell patents, owned three small but essential parts of the telephone equipment placed with subscribers by plaintiff. These parts were the transmitter, receiver and an induction coil, and were commonly known as the instruments. On that date the American Company sold to plaintiff the instruments then in service or in the supplies of plaintiff, at a price based upon then average price charged the American Company by Western Electric Company, the manufacturer of the instruments, less an allowance of 20% to reflect the condition of the instruments.

The purchase price for the toll plant was agreed upon as being an amount equal to the cost of reproduction less deterioration, determined by a field inspection and detailed appraisal; and that of the instruments was approved by qualified engineers of the plaintiff. A tabulation of these purchases as compared with the book cost to the American Company shows:

| 169<br>Total plant | Purchase price | American book cost | American depreciation reserve | American net book cost | Cost of purchase price over net book cost |
|---|---|---|---|---|---|
| 11/1/25 | $5,831,884.78 | $5,010,340.19 | $801,858.95 | $4,208,481.24 | $1,623,403.54 |
| 9/1/26 | 97,310.39 | 95,924.66 | 14,449.20 | 81,475.46 | 15,834.93 |
| 12/31/28 | 44,246.30 | 28,077.64 | 4,144.78 | 23,932.86 | 20,313.44 |
| | 5,973,441.47 | 5,134,342.49 | 820,452.93 | 4,313,889.56 | 1,659,551.91 |
| *Instruments* | | | | | |
| 12/31/27 | 6,661,238.91 | 8,135,224.98 | 3,980,944.73 | 4,154,280.25 | 2,506,958.66 |
| | 12,634,680.38 | 13,269,567.47 | 4,801,397.66 | 8,468,169.81 | 4,166,510.57 |

At the time of these transactions, plaintiff was a telephone company within the meaning of the Interstate Commerce Act and subject to Section 20 of that Act (24 Stat. 379, 386 as amended by 34 Stat. 584, 598, 594), and was prohibited by that section from keeping any other accounts than those prescribed by the Interstate Commerce Commission. That Commission, on December 10, 1912, prescribed a uniform system of accounts for telephone companies, and that system, as interpreted by the Interstate Commerce Commission, by Instruction 10, provided:

"10. Costs to be actual money costs.—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. * * *"

Instruction 13 of that system provided, in part:

"13. Plant and equipment and other property purchased.—When any property in the form of a going or completed plant is purchased, an appraisal of the property so acquired should be made, and the different constituent elements of the plant (and equipment, if any) or other property acquired should be appraised at their structural value; that is to say, at the estimated cost of replacement or reproduction less deterioration to the then existing conditions through wear and tear, obsolescence, and inadequacy. If the actual money value of the consideration given for th plant or other property was at the time of the acquisition in excess of such appraised value, the excess should be charged to account No. 204. Other Intangible Capital, and the appraised values of the constituent elements should be charged to the appropriate fixed capital accounts as hereinafter designated. If the actual money value of the consideration given was not in excess of such appraised value, such actual money value should be distributed
170 through the said accounts in proportion to the said appraised value of the constituent elements appropriate to the respective accounts. * * * *"

The accounting bulletin adopted by the Interstate Commerce Commission on June 26, 1916, provided in case No. 30:

"Query.—What items should be classified as 'going or completed plant' under section 13, page 33, 'Plant and equipment and other property purchased' of the Uniform System of Accounts for Class A and B companies?

"Answer.—The term 'going or completed plant' is intended to cover only the entire plant of a telephone company or an important unit thereof; such as—

(1) A telephone company as a whole.
(2) An entire central office.
(3) A system of lines and stations within a given area, or
(4) A complete section of toll plant.

"The purchase by one company from another of several poles and appurtenances, a switchboard, or other minor portions of plant shall be treated in the same manner as the purchase of materials and supplies: i. e., the purchasing company shall charge the fixed capital accounts at cost, as provided in section 10, page 33, of the Uniform System of Accounts for Class A and B companies."

Plaintiff, purporting to act under Instruction 13, and treating the acquisition of the plant as coming within case No. 30, distributed the $5,973,441.47, which it claimed was the actual cost to it of that property, among its various plant accounts in the precise amount of appraised structural value of the various types

of property purchased; and purporting to act under Instruction 10, recorded the $6,661,238.91, which it claimed to have paid for the instruments, in the plant accounts.

The Interstate Commerce Commission's system of accounts continued in effect until January 1, 1933, on which date a revised system became effective, which continued in force until January 1, 1937, the effective date of the uniform system of accounts for telephone companies prescribed by the defendant Federal Communications Commission. The revision of the system by the Interstate Commerce Commission as of January 1, 1933, did not require any change by the plaintiff in the accounting which it had performed with respect to the transactions in question.

171 The Communications Act of 1934 (48 Stat. 1064; 47 U. S. C. A. Sections 51 et seq.) approved June 19, 1934, became effective upon the organization of the Commission on July 11, 1934, except as to Sections 1 and 4 thereof, which became effective on July 1, 1934; and plaintiff was and is engaged in interstate and foreign communication by wire and radio within the meaning of Section 2 of that Act.

Under that Act, the defendant, Federal Communications Commission, is given power to "Make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions," § 4 (1); to "At any time require any such carrier (which, by definition in 3 (h) would include this plaintiff) to file with the Commission a statement showing the original cost at the time of dedication to the public use of all or any part of the property owned or used by said carrier. * * * If the carrier owning the property at the time such original cost is reported shall have paid more or less than the original cost to acquire the same, the amount of such cost of acquisition, and any facts which the Commission may require in connection therewith, shall be reported with such original cost," § 213 (e); to prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act," § 220 (a), and under subdivision (c) of the same section, the "burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by any such person." And under subdivision (g), "After the Commission has prescribed the form and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission.

By Section 604 (a), "All orders, determinations, rules, regulations, * * * which have been issued, made or granted by the Interstate Commerce Commission * * * under any provision of law repealed or amended by this Act, or in the exercise of duties, powers or functions transferred to the Commission by this Act, and which are in effect at the time this Section takes effect, shall continue in effect until modified, terminated, superseded or repealed by the Commission or by operation of law."

On June 19, 1935, the defendant Commission issued telephone division order No. 7-G, which prescribed for the plaintiff and other telephone companies, a system of accounts effective January 1, 1936, which differed from both systems theretofore prescribed by the Interstate Commerce Commission. Insofar as we are now interested, this system of accounts prescribed, as to balance sheet accounts and investments, that account 100.1. "Telephone plant in service" shall include the original cost (defined in § 31.01-3 (k) as meaning" the actual money cost of * * * property at the time when it was first dedicated to the public use,
whether by the accounting party or by predecessors"), of
172 the company's property used in telephone service at the
date of the balance sheet; and Account 100.4, "Telephone plant acquisitions adjustment," should include amounts determined in accordance with § 31.2-21 representing the difference between (1) the amount of money actually paid for telephone plant acquired, plus expense of acquisition and (2) the original cost of such plant less the amount of reserve requirements for depreciation and amortization of the property acquired. "(c) The amounts recorded in this Section with respect to each property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct." Section 21.2-21 relating to telephone plant acquired provided that when substantially complete toll line was acquired from predecessors, and charged to account 276, "Telephone plant acquired," the accounting shall be completed as follows: The original cost shall be charged to the telephone plant accounts as appropriate and credited to Account 276; the reserve requirements for depreciation, and amortization shall be credited to Account 171 "depreciation reserve," and Account 172 "amortization reserve," and debited to Account 276; and the amount remaining in Account 276 shall be debited or credited as appropriate to Account 100.4 "Telephone plant acquisition adjustment," with certain exceptions not important here.

The promulgation of this system of accounts was met by an action in which the American Company and other telephone companies, including this plaintiff, were plaintiffs, and the United States and Federal Communications Commission were defendants,

to enjoin and annul the proposed system. The plaintiffs were almost completely unsuccessful in this court (14 F. Supp. 121), and upon appeal, the Supreme Court affirmed, 292 U. S. 232. In this court, the defendants denied that the definition of original cost would require the plaintiffs to restate as of January 1, 1936, their property investment accounts by eliminating therefrom the recorded cost or investment of the plaintiff in property theretofore acquired from another public utility.

The Statutory Court made findings of fact, in part, as follows: V, that the order 7–C does not require that the recorded cost or investment in plaintiff's property theretofore acquired from another public utility be obliterated or eliminated from their investment accounts, but merely requires the plaintiffs to segregate the element of recorded cost or investment into investment accounts 100.1–2–3–4; VIII, that the order does not prevent plaintiffs from recovering amounts included in accounts 100.4 in view of the alternative provisions in paragraph C, and the Commission has made no direction in paragraph C, and the Commission has made no direction with respect to the disposition of any such accounts; XI, that the order does not require plaintiffs to write off any portion of their actual investment where they had paid in excess of the original cost; XII, does not require plaintiffs to make radical or retroactive changes in their completed accounts, but merely requires the reclassification of balances as of its effective date in certain balance sheet accounts; and XIII, it does not require that amounts recorded in account 100.4 be disposed of, written
173 off, or amortized by plaintiff's the form of accounting to be performed is dependent upon the development of facts in connection with each individual acquisition. And in the 13th conclusion of law, the lower court found that the order was not retroactive in its requirements.

In the Supreme Court, Mr. Justice Cardozo wrote in part:

"The argument is that account 100.4 representing the difference between original and present cost, is not to be reckoned, either wholly or in part, as a statement of existing assets, but must be written off completely. The Commission is charged, we are told, with a mandatory duty to extinguish the entire balance recorded in that account, its presence under the title of 'investments', having the effect of a misleading label. To give support to that conception of official duty, they rely on subdivision (c), which provides, as we have seen, that 'the amounts recorded in this account with respect to each property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct.'

"If subdivision (c) had the meaning thus imputed to it, there would be force in the contention that the effect of the order is to

distort in an arbitrary fashion the value of the assets. But the imputed meaning is not the true one. The Commission is not under a duty to write off the whole or any part of the balance in 100.4, if the difference between original and present cost is a true increment of value. On the contrary, only such amount will be written off as appears, upon an application for appropriate directions, to be a fictitious or paper increment. This is made clear, if it might otherwise be doubtful, by administrative construction. * * *

"To avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed, we requested the Assistant Attorney General to reduce his statements in that regard to writing in behalf of the Commission. He did this and informs us that 'the Federal Communications Commission construes the provisions of Telephone Division Order No. 7-C, issued June 19, 1935, pertaining to account 100.4' as meaning 'that amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and in accordance with paragraph (C) of account 100.4, provision will be made for their amortization.'

174 "We accept this declaration as an administrative construction binding upon the Commission in its future dealings with the companies. * * * The administrative construction now affixed to the contested order devitalizes the objection that the difference between present value and original cost is withdrawn from recognition as a legitimate investment.

"We are not impressed by the argument that the classification is to be viewed as arbitrary because the fate of any item, its ultimate disposition, remains in some degree uncertain until the Commission has given particular directions with reference thereto. By being included in the adjustment account, it is classified as provisionally a true investment, subject to be taken out of that account and given a different character if investigation by the Commission shows it to be deserving of that treatment. Such a reservation does not amount to a departure from the statutory power to fix the forms of accounts for 'classes' of carriers rather than for individuals. The forms of the accounts are fixed, and fixed by regulations of adequate generality. What disposition of their content may afterwards be suitable upon discovery that particular items have been carried at an excessive figure must depend upon evidentiary circumstances, difficult to define or catalogue in advance of the event. If once there was any need for explanation more precise than that afforded by the order, it is now supplied, we think,

by an administrative construction, which must be read into the order as supplementary thereto."

It is to be observed that this case did not decide what power the Commission had other than to order a uniform system of accounts. The order 7–C was clearly found to be within the law as a constitutional and statutory exercise of the powers conferred upon the Commission by the Communications Act of 1934. While appellants in that case complained that the system of accounting might authorize the Commission in the future to do something toward obliterating or striking out the difference between original cost and purchase price, the court refused to adjudicate as to the validity of the system based upon any such anticipated action. It left the determination of that point to be decided upon whatever facts might subsequently be revealed as justifying it. It would seem that the only question here is whether the Commission now has power to direct the debit to surplus and the other charges of which complaint is now made. The other case stopped short of deciding that.

From time to time after the acquisition of the toll plant and instruments, certain units of both have been retired and written out of the plant accounts at the amounts recorded therein and the same amount less salvage has been charged to depreciation reserve. Out of the total plant purchased at a cost of \$5,973,441.27, there remained in the plant accounts as of Jan. 1, 1937, toll plant of an estimated book cost of \$2,971,058.99, and as of Jan. 1, 1942, an estimated book cost of \$2,611,586.39. Out of the instruments
175 purchased at a cost of \$6,661,238.91, there remained in the plant accounts as of Jan. 1, 1937, instruments having an estimated book cost of \$2,433,105.41, and as of Jan. 1, 1942, an estimated book cost of \$630,279.13.

Here the accounting practice followed by the plaintiff, at the time of and for a number of years after the acquisition of the toll plant and instruments, was, in our opinion, in conformity with the rules of the Interstate Commerce Commission. Testimony that it did not follow good accounting practice would be immaterial if the practice followed was within the regulations then in force.

When the "original cost" theory was introduced by the Communications Act of 1934, insofar as telephone companies were concerned, a new system of accounting was devised by the Federal Communications Commission which required for the first time the segregation of the so-called "profit" into an account other than that in which original cost was entered. At that time some portion of the toll plant and instruments had been retired. The right to make the segregation was attacked in the A. T. & T. case, one of

the reasons given being that because segregation was required, the difference between original cost and the alleged purchase price "must be written off completely * * * the Commission is charged * * * with the mandatory duty to extinguish the entire balance recorded in" account 100.4 pursuant to subdivision (C) of that accounting requirement. Mr. Justice Cardozo answered that as above quoted.

The administrative construction referred to, and plainly appearing in the stipulation then filed by the counsel for the Federal Communications Commission, is not present in any of the other cases to which our attention has been called; and this case, for that reason, if for no other, is clearly to be distinguished from those cited. That administrative construction, if none other, it seems to us, precludes the action now taken until (1) there has been a "fair consideration of all the circumstances," and (2) unless the difference between the original and present cost is not "a true increment of value" but is a "fictitious or paper increment"; and action to obliterate must depend upon "evidentiary circumstances" later to be developed.

Here there has been no determination whether the difference between original cost and the price claimed to have been paid is a true increment of value, unless it is the arbitrary determination that it cannot be because it is the result of a transaction between a parent and an affiliate. There might be real doubt to make such a determination if based upon any such theory. New York Edison Co. v. Maltbie, 244 App. Div. 685–689, aff'd 271 N. Y. 103.

The order under review proceeds upon the theory that plaintiff's accounting in question was improper when made and should be corrected. In our opinion the entries made at the time of the four transactions in question accorded with the system prescribed by the Interstate Commerce Commission. They were recorded
176 at "actual money costs," and we do not understand that the
fairness of the appraisals then made is questioned. Defendants' position is that the fairness of the appraisals is immaterial because in transactions between affiliates the transferee is bound to take the transferor's net book cost. But if the entries were correct when made, as we now determine, the defendant Commission, under the present record, cannot apply retroactively a new system to write down the plaintiff's surplus. Arizona Grocery v. Atchison Ry., 284 U. S. 370–389.

That this is so seems all the more true in view of the stipulation of these same defendants made in A. T. & T. v. U. S. supra; certainly in the absence of proof that the excess of price over the seller's net book cost was not a "true increment of value." There has not been any determination based upon a fair consideration of all the circumstances in accordance with the stipulation mentioned,

nor upon the evidentiary circumstances referred to in the opinion of the Supreme Court.

The motion for summary judgment is, therefore, denied.

Dated August 24, 1944.

THOMAS W. SWAN,
*U. S. Circuit Judge.*
JOHN W. CLANCY,
*U. S. District Judge.*
JOHN BRIGHT,
*U. S. District Judge.*

178. In United States District Court

[Title omitted.]

The form of the within order and judgment is approved.

RALPH W. BROWN,
FRANK A. FRITZ,
HENRY J. FRIENDLY,
*Attorneys for New York Telephone Company,*
(S) By HENRY J. FRIENDLY,
(S) JOHN F. X. MCGOHEY,
*U. S. Atty.,*
*Attorney for United States of America.*
(S) HARRY M. PLOTKIN,
*Attorney for Federal Communications Commission.*

179 In United States District Court, Southern District of New York

Civ. 24-211

NEW YORK TELEPHONE COMPANY, PLAINTIFF

*v.*

UNITED STATES OF AMERICA AND FEDERAL COMMUNICATIONS COMMISSION, DEFENDANTS

*Judgment*

Jan. 2, 1945

This cause having come on to be heard upon the motion of plaintiff for final judgment in its favor and against the defendants for the relief demanded in the complaint, pursuant to the direction of this Court by order dated herein on December 28, 1944, it is

Ordered, adjudged, and decreed that the order adopted by defendant Federal Communications Commission under date of December 14, 1943, requiring the above named plaintiff to debit its surplus account in the sum of $4,166,510.57 and to make other

changes in its accounts, as amended by supplemental order dated January 25, 1944, is and has at all times been beyond the lawful authority of said defendant and in violation of the legal rights of the plaintiff and wholly illegal and void, and it is further.

Ordered, adjudged, and decreed that said order be permanently enjoined, set aside, suspended and annulled and that the enforcement thereof be permanently restrained and enjoined, and it is further

Ordered, adjudged, and decreed that, notwithstanding the foregoing, the plaintiff shall continue to maintain its Account No. 180, Surplus Reserved, the said sum of $4,166,510.57 which plaintiff has credited to said account pursuant to the said supplemental order of defendant Federal Communications Commission
180 dated January 25, 1944, until sixty days after the date of the
entry of this judgment and if prior to the expiration of such sixty-day period an appeal from this judgment to the Supreme Court of the United States be taken by the defendants, or either of them, the plaintiff shall continue to maintain said sum in its Account No. 180 pending the final determination of such appeal, provided that such appeal be diligently prosecuted.

Dated New York, N. Y., January 2, 1945.

(S) George H. Follmer,
*Clerk.*

The form of the foregoing judgment is hereby approved and the Clerk of this Court is hereby directed to enter the same.

(S) Thomas W. Swan,
*U. S. Circuit Judge.*

(S) John W. Clancy,
*U. S. District Judge.*

(S) John Bright,
*U. S. District Judge.*

181 In United States District Court, Southern District or New York

Civ. 24-211

New York Telephone Company, plaintiff

*v.*

United States of America and Federal Communications Commission, defendants

*Findings of fact and conclusions of law*

Filed Jan. 2, 1945

The above-named defendants having applied to this Court for summary judgment in their favor, and the said motion having

duly come on to be heard before a Statutory Court constituted under the provisions of the Urgent Deficiencies Appropriation Act, 38 Stat. 219, 28 U. S. C. A. Section 41 (28) and Sections 46 and 48, consisting of Hon. Thomas W. Swan, Hon. John Bright, and Hon. John W. Clancy, convened pursuant to order dated March 17, 1944, and plaintiff and defendants having stipulated in open court that upon the determination of said motion, final judgment might be entered as on a final hearing in favor of the party in whose favor said motion should be decided, and due deliberation having been had thereon, it is

Ordered, that the aforesaid motion of the defendants for summary judgment in their favor be and the same is in all respects denied, and it is further

Ordered, that the Court hereby makes its findings of fact and conclusions of law as follows:

*Findings of fact*

I. Plaintiff is a corporation duly organized and existing under the laws of the State of New York. Plaintiff has its principal office in the City of New York, State of New York, and in
182 the Southern District thereof. Plaintiff maintains its principal books of account in the City of New York, State of New York, and in the Southern District thereof. Plaintiff has been engaged since its incorporation in 1896, and is now engaged, in the business of furnishing telephone service to the public in the States of New York and Connecticut. In that business it furnishes local or exchange telephone service in towns, cities and other localities in said states. It also furnishes intrastate and interstate toll or long distance service between points in said states and interstate and foreign toll service through physical connection with the lines of other telephone companies between points in said states and points outside thereof.

II. The defendant Federal Communications Commission is an administrative agency created by the Communications Act of 1934 (48 Stat. 1064, 47 U. S. C. A. § 151 et seq.) and is charged with the execution and enforcement of said Act.

III. By an order dated December 14, 1943, defendant Commission directed plaintiff to reduce its surplus account by $4,166,510.57 which the Commission found to represent the excess of payments by plaintiff to the American Telephone and Telegraph Company (hereinafter referred to as the "American Company") for telephone plant purchased by plaintiff on November 1, 1925, September 1, 1926, December 31, 1927, and December 31, 1928, over the book cost of such telephone plant less an allocated part of the depreciation reserve appearing on the books of the American

Company at the time of acquisition, and to balance such charge to surplus by increasing its plant accounts by an amount of \$194,886.97, decreasing its investment account, "Telephone plant acquisition adjustment" by an amount of \$481,439.60, and increasing its depreciation reserve by an amount of \$3,879,957.94. In an order dated January 25, 1944, the defendant Commission, having regard to this impending action to review its order of
183 December 14, 1943, amended its prior order to extend the time within which the prescribed entries would have to be made until further order of the Commission, upon condition that the \$4,166,510.57 ordered to be debited to surplus account be debited to surplus and credited to "surplus reserved" and be held in suspense pending such further order.

IV. At all times material herein the American Company has owned all of the outstanding common stock of the plaintiff. However, plaintiff has maintained its own books, records and accounts separate and distinct from those of the American Company and has also maintained its own employees, property and business separate and apart from the employees, property and business of the American Company. At the time of the acquisitions referred to in Findings V to IX infra, plaintiff had outstanding in the hands of the public 250,000 shares of 6½% cumulative preferred stock and in excess of \$132,000,000 of mortgage bonds. All of plaintiff's officers, and at least two-thirds of its directors were not directors, officers or employees of the American Company.

V. Prior to 1925 the American Company had furnished intrastate toll service between certain points in New York. In that year, pursuant to agreement between the plaintiff and the American Company, such business was transferred to plaintiff and in order to conduct the business so transferred the plaintiff purchased from the American Company certain toll plant consisting of tangible property such as poles, cross arms, guys and anchors, aerial wire and cable, underground cable, loading coils, conduit, and right of way. The purchase was effected as of November 1, 1925, and September 1, 1926.

VI. As of December 31, 1928, the plaintiff purchased from the American Company a small amount of additional toll plant which was required in order to handle certain interstate toll business which had been transferred to plaintiff by such company.
184 VII. Prior to December 31, 1927, the American Company as owner of the fundamental Bell Patents owned three small but essential parts of the telephone equipment placed with subscribers by plaintiff. These parts were the transmitter, receiver and an induction coil, and were commonly known as the

"instruments." On December 31, 1927 the American Company sold to plaintiff the instruments then in the service or supplies of plaintiff.

VIII. The purchase price of the toll plant agreed upon was to be an amount equal to its "structural value," i. e., its cost of reproduction new less deterioration, determined by a field inspection and detailed appraisal. Such inspection and appraisal were made by qualified engineers of the plaintiff and the American Company and the plaintiff paid to the American Company a total of $5,973,441.47 shown by the appraisal to be the "structural value" of the property purchased.

IX. The purchase price of the instruments agreed upon was $6,661,238.91 which was based upon the average price charged the American Company by the Western Electric Company, manufacturer of the instruments, during the first nine months of 1927, less an allowance of 20% to reflect the then condition of the instruments. This price was approved by qualified engineers of the plaintiff.

X. The defendant Federal Communications Commission in the proceeding before it resulting in its order dated December 14, 1943, as described in Finding III, supra, made no determination with respect to the value of any of the property purchased by the plaintiff from the American Company and counsel for the defendants in this action, upon oral argument, informed the Court that the Commission was not relying on any claim or over-valuation and that for the purposes of this action no such issue existed.

XI. At the time of the acquisitions referred to in Findings V to IX, supra, plaintiff was a telephone company within the meaning of the Interstate Commerce Act, subject to Section 20 of that Act and was prohibited from keeping any other accounts than those prescribed by the Interstate Commerce Commission.

XII. The Interstate Commerce Commission on December 10, 1912, effective January 1, 1913, prescribed a Uniform System of Accounts for telephone companies subject to its jurisdiction under Section 20 of the Interstate Commerce Act. This system continued in effect without substantial change until January 1, 1933.

XIII. Instruction 10 of said System of Accounts provided:

"10. Costs to be actual money costs.—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount

charged should be the actual money value of such consideration at the time of the transaction."

XIV. Instruction 13 of said System of Accounts provided:

"13. Plant and equipment and other property purchased.—When any property in the form of a going or completed plant is purchased, an appraisal of the property so acquired should be made, and the different constituent elements of the plant (and equipment, if any) or other property acquired should be appraised at their structural value; that is to say, at the estimated cost of replacement or reproduction less deterioration to the then existing conditions through wear and tear, obsolescence, and inadequacy. If the actual money value of the consideration given for the plant or other property was at the time of the acquisition in excess of such appraised value, the excess should be charged to account No. 204, 'Other Intangible Capital,' and the appraised values of the constituent elements should be charged to the appropriate fixed capital accounts as hereinafter designated. If the actual money value of the consideration given was not in excess of such appraised value, such actual money value should be distributed
186 through the said accounts in proportion to the said appraised value of the constituent elements appropriate to the respective accounts.

"Companies should be prepared to furnish the Commission, upon demand, a full report of the contract of acquisition, the consideration given therefor, the determination of the actual money value of such consideration if other than money, the appraisal, and the amounts charged to the respective accounts for each plant or other such fixed capital purchased. The purchaser is required to procure in connection with the acquisition of any such plant or other fixed capital all existing records, memoranda, and accounts in the possession or control of the grantor relating to the construction and improvement of such plant, and to preserve such records, memoranda, and accounts until authorized by law to destroy or otherwise dispose of them."

XV. Accounting Bulletin No. 11 adopted by the Interstate Commerce Commission on June 26, 1913, interpreting the provisions of said System of Accounts, Case No. 30, provided:

"Query.—What items should be classified as 'going or completed plant' under section 13, page 33, 'Plant and equipment and other property purchased' of the Uniform System of Accounts for Class A and B companies?

"Answer.—The term 'going or completed plant' is intended to cover only the entire plant of a telephone company or an important unit thereof; such as—

(1) A telephone company as a whole,

(2) An entire central office,

(3) A system of lines and stations within a given area, or

(4) A complete section of toll plant.

"The purchase by one company from another of several poles and appurtenances, a switchboard, or other minor portions of plant shall be treated in the same manner as the purchase of materials and supplies; i. e., the purchasing company shall charge the fixed capital accounts at cost, as provided in section 10, page 33, of the Uniform System of Accounts for Class A and B companies."

XVI. Plaintiff, purporting to act under Instruction 13 and treating the acquisition of the toll plant as coming within the definition of "going or completed plant" contained in Case No. 30 in Bulletin No. 11, distributed the $5,973,441.47, which it
187 had paid for that property, among its various plant accounts in the precise amount of the appraised structural value of the various classes of plant purchased.

XVII. Plaintiff, purporting to act under Instruction 10 and treating the acquisition of the instruments as not coming within the definition of "going or completed plant" contained in Case No. 30 in Bulletin No. 11, recorded in its plant accounts the $6,661,238.91 which it had paid for the instruments.

XVIII. Effective January 1, 1933, the Interstate Commerce Commission issued a Revised System of Accounts which continued in force until January 1, 1937, the effective date of a System of Accounts for Telephone Companies prescribed by the defendant Commission. Such Revised System of Accounts did not require any change by the plaintiff in the accounting which it had performed with respect to the property which it had acquired from the American Company as described in Findings V to IX supra.

XIX. The Communications Act of 1934 (48 Stat. 1064, 47 U. S. C. A. §§ 151 et seq.) approved June 19, 1934, became effective upon the organization of the Commission on July 11, 1934, except as to Sections 1 and 4 thereof which became effective on July 1, 1934, and plaintiff was and is engaged in interstate and foreign communication by wire and radio within the meaning of Section 2 of that Act.

XX. On June 19, 1935, the defendant Commission issued telephone division order No. 7–C which prescribed for the plaintiff and other telephone companies, a system of accounts effective January 1, 1936, which differed from both systems theretofore prescribed by the Interstate Commerce Commission. Insofar as material to this proceeding this system of accounts prescribed, as to balance sheet accounts and investments, that account 100.1, "Telephone plant in service" should include the original cost (defined as meaning "the actual money cost of * * * property

188 at the time when it was first dedicated to the public use, whether by the accounting party or by predecessors"), of the company's property used in telephone service at the date of the balance sheet; that Account 100.4, "Telephone plant acquisitions adjustment," should include amounts representing the difference between (1) the amount of money actually paid for telephone plant acquired, plus expense of acquisition and (2) the original cost of such plant less the amount of reserve requirements for depreciation and amortization of the property acquired; and that the amounts recorded in Account 100.4 with respect to each property acquisition should be disposed of, written off, or provision should be made for the amortization thereof in such manner as the Commission might direct.

XXI. Upon the promulgation by the Commission of said proposed Uniform System of Accounts, plaintiff and a number of other telephone companies filed in this Court a complaint against the defendants herein in a suit entitled "American Telephone and Telegraph Company, et al., plaintiffs, against United States of America and Federal Communications Commission, defendants, In Equity No. 81-366" to enjoin, set aside, annul, and suspend the said proposed Uniform System of Accounts, and the effective date of said proposed Uniform System of Accounts was stayed pending said suit. In said suit plaintiffs claimed that the proposed Uniform System of Accounts would require them to write off a portion of their investment in telephone plant. Defendants denied that the definition of original cost would require the plaintiffs to restate as of January 1, 1936 (the effective date of the proposed System of Accounts) their property investment accounts by eliminating therefrom the recorded cost or investment of the plaintiff in property theretofore acquired from another public utility.

XXII. This Court in said suit made findings of fact, in part, as follows:

189 "III

"Telephone Division Order No. 7-C requires plaintiffs to include in the telephone plant accounts the 'original cost' of their telephone plant, and provides that the difference between said original cost and cost to the accounting company of property acquired from another utility shall be recorded on their books in other specified investment accounts.

"IV

"Plaintiffs have heretofore performed accounting with respect to property acquired from other public utilities which resulted in the inclusion in their telephone plant accounts of amounts repre-

senting various costs, such as current cost new, actual cost to plaintiffs, structural value, or cost to the predecessor company (by merger of book accounts). The Uniform System of Accounts prescribed by Telephone Division Order No. 7-C requires that in accounting for property acquired from another public utility, and in all other instances, plaintiffs' telephone plant accounts shall be stated on a uniform basis, that being 'original cost,' as therein defined.

"V

"Telephone Division Order No. 7-C does not require that the recorded cost or investment of the plaintiffs in property theretofore acquired by them from another public utility be obliterated or eliminated from their investment accounts, but merely requires plaintiffs to segregate the elements of recorded cost or investment into the following investment amounts:

100.1 Telephone plant in service.
100.2 Telephone plant under construction.
100.3 Property held for future telephone use.
100.4 Telephone plant acquisition adjustment.

"VI

"Telephone Division Order No. 7-C further requires plaintiffs to include in their investment accounts the amount which they actually pay for property acquired on and after January 1, 1936, from other public utilities.

"VII

"Telephone Division Order No. 7-C requires plaintiffs to segregate in an account numbered 100.4 and entitled 'Telephone plant acquisition adjustment,' the difference between (a) the amount of money which they actually paid for telephone plant acquired and (b) the original cost of such plant less the amounts of reserve requirements for depreciation and amortization of the property acquired and amounts of contributions to the predecessor company or companies for the construction and acquisition of such property.

190 "VIII

"The plaintiffs are not prevented by Telephone Division Order No. 7-C from recovering amounts included in Account 100.4 in view of the alternative provisions of paragraph (c) of the text of said Account 100.4, which make provision for the amortization or other appropriate disposition of amounts included in Account 100.4. The Commission had made no direction with respect to the disposition of any such amounts.

"IX

"Telephone Division Order No. 7–C requires that plaintiffs' accounts shall be kept on a basis which will reflect the facts with respect to their transactions and which will show their actual condition for the information of all persons interested therein, except with respect to contributions to predecessor utilities and depreciation of property held for future telephone use, and said order is capable of practical application except with respect to contributions to predecessor utilities.

"X

"Telephone Division Order No. 7–C does not prevent plaintiffs from recording in their expense accounts the expense of depreciation which they actually incur, except that said order does not provide for depreciation of the classes of depreciable property, the original cost of which is includible in Account 100.3, 'Property held for future telephone use.'

"XI

"Telephone Division Order No. 7–C does not require plaintiffs to write off any portion of their actual investment where they have paid a price in excess of original cost, but merely requires a segregation of this actual cost into certain investment accounts, all of which will appear in the balance sheet statements of plaintiffs; and no writing off is required by the provisions of Order No. 7–C when plaintiffs purchase property in the future, but only a segregation of such cost is required.

"XII

"Telephone Division Order No. 7–C does not require plaintiffs to make radical or retroactive changes in their completed accounts. In this respect said order merely requires the reclassification of balances as of its effective date in certain balance-sheet accounts.

"XIII

"Telephone Division Order No. 7–C does not require that amounts recorded in Account 100.4 be disposed of, written off, or amortized by plaintiffs. The form of the accounting to be performed is dependent upon the development of facts in connection with each individual acquisition. Said order merely provides for alternative modes of disposition adaptable to the facts of individual acquisitions."

191 This Court in said suit also made the following conclusion of law:

"XIII

"Telephone Division Order No. 7-C is not retroactive in its requirements."

XXIII. The plaintiffs in said suit appealed from the judgment of this Court to the Supreme Court of the United States. The Supreme Court, although affirming the judgment of this Court, in order "to avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed" required the defendants to file with it a memorandum embodying the interpretation of the proposed Uniform System of Accounts on which the defendants had relied in defending said suit, and the Supreme Court accepted this declaration as "an administrative construction binding upon the Commission in its future dealings with the companies." Said interpretation provided:

"(1) That amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provision will be made for their amortization.

"(2) That when amounts included in account 100.4 are deemed, after a fair consideration of all the circumstances, to be definitely attributable to depreciable telephone plant, provision will be made for amortization of such amounts through operating expenses, through the medium of either account 613 (R. 186) or account 675 (R. 205).

"The Commission believes that the foregoing construction of its order is that which it presented to the District Court through the affidavits of its witnesses."

XXIV. After the decision of the Supreme Court, the defendant Commission entered an order making the new Uniform System of Accounts effective January 1, 1937, and said System of Accounts has remained in effect since that date without substantial modification.

XXV. From time to time after the acquisition of the toll
192 plant and instruments by the plaintiff as set forth in Findings V to IX supra, certain units of both have been retired and written out of the plant accounts at the amounts recorded therein, and the same amount less salvage has been charged to depreciation reserve. Out of the toll plant purchased by the plaintiff from the American Company at a cost of $5,973,441.27,

there remained in the plant accounts as of January 1, 1937, toll plant having an estimated book cost of $2,971,058.99, and as of January 1, 1942, toll plant having an estimated book cost of $2,611,586.39. Out of the instruments purchased by the plaintiff from the American Company at a cost of $6,661,238.91, there remained in the plant accounts as of January 1, 1937, instruments having an estimated book cost of $2,433,105.41, and as of January 1, 1942, instruments having an estimated book cost of $630,279.13.

XXVI. The accounting entries made by plaintiff with respect to the toll plant and instruments purchased by it from the American Company from the time of their acquisition until January 1, 1937, were made in conformity with the rules which had been prescribed by the Interstate Commerce Commission and which were in effect during that period.

*Conclusions of law*

I. This Court has jurisdiction to entertain this action by virtue of Section 402 (a) of the Communications Act of 1934 (48 Stat. 1064, 1093, 47 U. S. C. A. § 402 (a) and the Urgent Deficiencies Appropriations Act (38 Stat. 219, 28 U. S. C. A. §§ 41 (28), 46 and 48).

II. At the time of the acquisitions referred to in Findings of Fact V to IX supra, plaintiff was subject to the exclusive jurisdiction of the Interstate Commerce Commission with respect to its accounting and was prohibited from keeping any accounts other than those prescribed by that Commission, and plaintiff remained subject to the accounting rules which had been prescribed by said Interstate Commerce Commission until January 1, 1937, when the Uniform System of Accounts prescribed by the defendant Commission became effective.

193 III. The accounting entries made by the plaintiff with respect to the toll plant and instruments purchased by it from the American Company, from the time of their acquisition until January 1, 1937, were made in conformity with the rules which had been prescribed by the Interstate Commerce Commission and which were in effect during that period and were therefore the only lawful and correct entries to be made by the plaintiff.

IV. The defendant Commission has no power to apply retroactively a new system of accounts to write down the plaintiff's surplus with respect to entries which were lawfully and correctly made by the plaintiff under the Interstate Commerce Commission's prescribed System of Accounts.

V. The order described in Findings of Fact III sought to be enjoined in this proceeding attempts to apply retroactively the

Federal Communications Commission's System of Accounts to write down plaintiff's surplus with respect to entries made lawfully and correctly by the plaintiff under the Interstate Commerce Commission's prescribed System of Accounts.

VI. Under the stipulation of these defendants made in American Telephone and Telegraph Company, et al., against United States of America, et al., described in Findings of Fact XXIII, the defendant Commission cannot require the plaintiff to write off from its accounts amounts paid by it to another telephone company for property acquired by plaintiff from such other company in excess of the net book cost of the property to the vendor at the time of purchase, unless after a fair consideration of all circumstances, the Commission determines that such excess is not "a true increment of value" but is "a fictitious or paper increment."

VII. In making the order sought to be enjoined, the defendant Commission directed such a write off with respect to the
194 property purchased by the plaintiff from American Company, as set forth in Findings of Fact V to IX supra, without a fair consideration of all the circumstances and without any valid determination that such excess was not "a true increment of value," and such order therefore was made in violation of the stipulation referred to in Conclusion VI.

VIII. The determination that an amount paid by a telephone company for property to another telephone company in excess of the net book cost of such property to the vendor cannot be a true increment of value if the transaction was between affiliated companies, is arbitrary and therefore void and of no effect.

IX. The order sought to be enjoined is beyond the power of the Commission and is wholly illegal and void.

X. Said order should be permanently enjoined; set aside, suspended and annulled and the enforcement thereof permanently restrained and enjoined.

It is further ordered, that the Clerk of this Court be, and he hereby is, directed to enter final judgment, in form as approved by the Court, in favor of plaintiff for the relief demanded in the complaint.

Dated New York, N. Y., December 28, 1944.

(S) THOMAS W. SWAN,
*U. S. Circuit Judge.*

(S) JOHN W. CLANCY,
*U. S. District Judge.*

(S) JOHN BRIGHT,
*U. S. District Judge.*

[File endorsement omitted.]

195 In United States District Court

[Title omitted.]

*Petition for a direct appeal to the Supreme Court of the United States*

To The Hon. JOHN BRIGHT, District Judge for the Southern District of New York.

Now come the United States of America and the Federal Communications Commission, defendants herein, and feeling themselves aggrieved by the final order or decree of the District Court rendered and entered in the above-entitled cause on the 2nd day of January 1945, do hereby appeal therefrom to the Supreme Court of the United States because of errors prejudicial to defendants which are set forth in the assignment of errors presented and filed herewith, and pray that their appeal be allowed and that citation be issued as provided by law and that the record on appeal be made and certified and sent to the Supreme Court of the United States, in accordance with the rules of that Court.

CHARLES FAHY,
*Solicitor General of the United States of America.*
CHARLES R. DENNY,
*General Counsel of the Federal Communications Commission.*

Dated February 24, 1945.

196 In United States District Court

[Title omitted.]

*Assignment of errors*

Come now the United States of America and the Federal Communications Commission, defendants in the above-entitled cause, and file the following assignment of errors upon which they shall rely in the prosecution of the appeal to the Supreme Court of the United States herein petitioned for in said cause from the order, judgment and decree of the statutory three-judge District Court of the United States for the Southern District of New York entered on the 2nd day of January 1945.

(1) The Court erred in denying appellants' motion for summary judgment.

(2) The Court erred in issuing the injunction prayed for by appellee.

(3) The Court erred in its determination that the Federal Communications Commission was without power to promulgate the

order sought to be set aside by appellee, and in failing to hold that the Federal Communications Commission had authority to promulgate the said order.

(4) The Court erred in its determination that the action of the Commission in requiring the New York Telephone Company to write off from its accounts amounts paid by it to American Telephone and Telegraph Company for property acquired
197 from that company in excess of the net book cost of the property to that company at the time of the purchase did not constitute a fair consideration of all the circumstances and was not a valid determination that such excess was not a true increment of value within the meaning of the supplemental memorandum filed by the government in the case of American Telephone and Telegraph Company v. United States, 299 U. S. 232, and that the Commission's action was therefore in violation of the terms of that supplemental memorandum.

(5) The Court erred in its determination that the accounting entries here involved were made in compliance with then applicable rules and regulations of the Interstate Commerce Commission.

(6) The Court erred in its determination that the order of the Commission is invalid because it sought to apply retroactively the Federal Communications Commission's System of Accounts to write down appellee's surplus by requiring changes in certain accounting entries originally made by appellee in accordance with regulations of the Interstate Commerce Commission.

Wherefore, petitioners pray that the final order or decree entered herein on the 2nd day of January 1945, be reversed and that such other and further relief be granted as to the Court may seem just and proper.

CHARLES FAHY,
*Solicitor General of the United States of America.*
CHARLES R. DENNY,
*General Counsel of the Federal Communications Commission.*

Dated February 24, 1945.

198 In United States District Court

[Title omitted.]

*Order allowing appeal*

The defendants herein having filed a petition for appeal to the Supreme Court of the United States from the decree entered herein on January 2, 1945 and having filed their assignment of errors, it is,

Ordered, that an appeal by petitioners in the above-entitled cause to the Supreme Court of the United States from the decree heretofore filed and entered herein on January 2, 1945, be and the same is hereby allowed and that the record on appeal be made and certified and sent to the Supreme Court of the United States in accordance with the rules of that Court, said appeal being hereby made returnable forty (40) days from the date hereof.

Dated February 26, 1945.

(Sgd.) JOHN BRIGHT,
*United States District Judge.*

199 In United States District Court

[Title omitted.]

*Notice of appeal*

To The Honorable ATTORNEY GENERAL OF THE STATE OF NEW YORK; RALPH W. BROWN, Attorney for New York Telephone Company; FRANK A. FRITZ, Attorney for New York Telephone Company; HENRY J. FRIENDLY, Attorney for New York Telephone Company.

Pursuant to the Urgent Deficiencies Appropriation Act of October 22, 1913, Chap. 32, 38 Stat. 219, 220, you are hereby notified that the United States of America and the Federal Communications Commission, the above named defendants, have taken an appeal to the Supreme Court of the United States from the final decree of the specially constituted United States District Court entered herein January 2, 1945, denying the motion for summary judgment of said defendants and granting the relief sought by plaintiff in the suit by the New York Telephone Company to enjoin, set aside, annul, and suspend a certain order of the Federal Communications Commission designated Commission Order in Docket No. 6329, "In the Matter of the New York Telephone Company, Accounting," dated December 14, 1943, and the order allowing the said appeal makes the same returnable in the
200 Supreme Court of the United States forty (40) days from the date hereof.

Dated February 24, 1945.

CHARLES FAHY,
*Solicitor General of the United States of America.*
CHARLES R. DENNY,
*General Counsel of the Federal Communications Commission.*

201 In United States District Court

[Title omitted.]

*Praecipe for transcript of record*

*To the Clerk of the United States District Court for the Southern District of New York:*

You are hereby requested to make a transcript of record to be filed in the Supreme Court of the United States, pursuant to an appeal allowed in the above-entitled cause and to include in such transcript of record the following, and no other papers and exhibits, to wit:

1. Summons and Complaint, together with Exhibits A through G thereof.
2. Order convening three judge court.
3. Notice of Appearance of counsel for Federal Communications Commission.
4. Notice of Motion by United States and Federal Communications Commission for summary judgment and affidavit of Charles R. Denny annexed thereto [Exhibit A referred to therein should be transmitted as an original document—see item 16 of this praecipe.]
5. Motion to Intervene, and Notice thereof, of the Public Service Commission of the State of New York.
6. Order of the Court denying the motion of the Public Service Commission of the State of New York to Intervene.
7. Decision of the Court, dated August 24, 1944, denying the motion of the United States and the Federal Communications Commission for summary judgment.
8. Order and Judgment of the Court, entered January 2, 1945.
9. Petition for a Direct Appeal to the Supreme Court of the United States.
10. Assignment of Errors.
11. Statement as to Jurisdiction.

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12. Order Allowing Appeal.
13. Citation on Appeal.
14. Notice of Appeal.
15. Statement directing attention to Supreme Court Rule 12, para. 3.
16. Order Re Transmission of Original Documents.
17. Acceptance of Service of appeal papers.
18. Praecipe.

Said transcript to be prepared as required by law and the Rules of this Court, and the Rules of the Supreme Court of the United States, and is to be filed in the office of the Clerk of the Supreme Court.

Dated March 6, 1945.

CHARLES FAHY,
*Solicitor General of the United States of America.*
CHARLES R. DENNY,
*General Counsel of the Federal Communications Commission.*

Service of foregoing praecipe accepted and acknowledged this 8th day of March 1945.

HENRY J. FRIENDLY,
*Attorney for New York Telephone Company.*

203 In United States District Court

[Title omitted.]

*Order re transmission of original documents*

It is hereby directed that the original of Exhibit A to the affidavit of Charles R. Denny, filed March 29, 1944, be transmitted to the Supreme Court.

Dated February 24, 1945.

(Sgd.) JOHN BRIGHT,
*United States District Judge,*
*United States District Court for the Southern District of New York.*

Agreed to:

CHARLES FAHY,
Charles Fahy,
*Solicitor General of the United States of America.*
CHARLES R. DENNY,
Charles R. Denny,
*General Counsel of the Federal Communications Commission*
HENRY J. FRIENDLY,
Henry J. Friendly,
*Counsel for Plaintiff.*

204 [Citation in usual form filed Feb. 27, 1945, omitted in printing.]

204–A [Clerk's certificate to foregoing transcript omitted in printing.]

205 Supreme Court of the United States

*Stipulation as to record*

Filed April 19, 1945

Subject to the approval of this Court, it is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that the administrative record before the Commission—Exhibit A to defendants' Motion for Summary Judgment—which consists of approximately 3,000 pages and 84 exhibits, need not be printed as part of the record and that any party may refer in the briefs to any portions thereof and may include in an appendix to the briefs such portions of the administrative record as are deemed relevant.

Charles Fahy,
*Solicitor General of the United States of America.*
Henry J. Friendly,
*Counsel for Plaintiff.*

Dated April 16, 1945.

206 Supreme Court of the United States

*Statement of points to be relied upon and designation of the parts of the record to be printed*

Filed April 19, 1945

Comes now the appellant in the above-entitled cause and states that the points upon which it intends to rely in this Court in this case are as follows:

(1) The Court erred in denying appellants' motion for summary judgment.

(2) The Court erred in issuing the injunction prayed for by appellee.

(3) The Court erred in its determination that the Federal Communications Commission was without power to promulgate the order sought to be set aside by appellee, and in failing to hold that the Federal Communications Commission had authority to promulgate the said order.

(4) The Court erred in its determination that the action of the Commission in requiring the New York Telephone Company to write off from its accounts amounts paid by it to American Telephone and Telegraph Company for property acquired from

that company in excess of the net book cost of the property to that company at the time of the purchase did not constitute a fair consideration of all the circumstnces and was not a valid determination that such excess was not a true increment of value within the meaning of the supplemental memorandum filed by the government in the case of American Telephone and
207 Telegraph Company v. United States, 299 U. S. 232, and that the Commission's action was therefore in violation of the terms of that supplemental memorandum.

(5) The Court erred in its determination that the accounting entries here involved were made in compliance with then applicable rules and regulations of the Interstate Commerce Commission.

(6) The Court erred in its determination that the order of the Commission is invalid because it sought to apply retroactively the Federal Communications Commission's System of Accounts to write down appellee's surplus by requiring changes in certain accounting entries originally made by appellee in accordance with regulations of the Interstate Commerce Commission.

And the appellant further states that only the following parts of the record, as filed in this Court, need be printed by the Clerk in the hearing of the case:

1. Summons and Complaint, together with Exhibits A through G thereof.

2. Order convening three-judge court.

3. Notice of Motion by United States and Federal Communications Commission for Summary judgment and affidavit of Charles R. Denny annexed thereto [excluding Exhibit A referred to therein transmitted to this Court as an original document].

4. Proposed Report of the Federal Communications Commission in Docket No. 6329, P-30, adopted June 22, 1943.

5. Exceptions of New York Telephone Company to said proposed Report.

6. Decision of the Court, dated August 24, 1944, denying the motion of the United States and the Federal Communications Commission for summary judgment.

7. Order and Judgment of the Court, entered January 2, 1945.

8. Petition for a Direct Appeal to the Supreme Court of the United States.

9. Assignment of Errors.

10. Statement as to Jurisdiction.

11. Order allowing Appeal.

12. Citation on Appeal.

13. Notice of Appeal.

14. Statement directing attention to Supreme Court Rule 12, paragraph 3.

15. Order Re Transmission of Original Documents.
16. Acceptance of Service of Appeal papers.
208 17. Praecipe.
18. Stipulation as to Record, dated April 16, 1945.
19. Statement of points to be relied upon and designation of the parts of the record to be printed.

CHARLES FAHY,
*Solicitor General for the United States of America.*

Service of the foregoing Statement of Points to be Relied upon and Designation of the Parts of the Record to be Printed is hereby acknowledged this 17th day of April 1945.

HENRY J. FRIENDLY,
*Counsel for Appellee.*

[File Endorsement Omitted.]

209 Supreme Court of the United States

*Order noting probable jurisdiction*

May 7, 1945

The statement of jurisdiction in this case having been submitted and considered by the Court, probable jurisdiction is noted and the case is transferred to the summary docket.

[Endorsement on cover:] File No. 49578. D. C. U. S., Southern New York. Term No. 1125. The United States of America and Federal Communications Commission, Appellants vs. New York Telephone Company. Filed April 7, 1945. Term No. 1125 O. T. 1944.

U. S. GOVERNMENT PRINTING OFFICE 1945